No. 158

In the Supreme Court of the United States

OCTOBER TERM, 1951

THOMAS B. LILLY AND HELEN W. LILLY,
PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

BRIEF FOR THE RESPONDENT

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OPINIONS BELOW

The opinion of the Tax Court (R. 142–160) is reported in 14 T. C. 1066. The opinion of the Court of Appeals (R. 183–188) is reported in 188 F. 2d 269.

JURISDICTION

The judgment of the Court of Appeals was entered on April 2, 1951. (R. 188–189.) The petition for a writ of certiorari was filed on June 29, 1951, and was granted on October 8, 1951. (R. 193.) The jurisdiction of this Court rests on 28 U. S. C., Section 1254.

QUESTION PRESENTED

Taxpayers, who were engaged in the business of grinding, fitting and selling eye glasses, entered into oral contracts or understandings with various physicians, whereby taxpayers agreed to pay the physicians one-third of the retail price of all glasses purchased by patients guided to them by these physicians. In practically every instance the patient was unaware of the "kickback" paid to his doctor.

The question presented is whether the Tax Court and the court below properly held that these secret commissions or rebates paid to the doctors were not deductible by taxpayers under Section 23 (a) (1) (A) of the Internal Revenue Code as "ordinary and necessary" business expenses.

STATUTE AND REGULATIONS INVOLVED

Internal Revenue Code:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) [As amended by Sec. 121 (a) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Expenses.*

(1) *Trade or Business Expenses.*

(A) *In general.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allow-

ance for salaries or other compensation for personal services actually rendered; * * *

* * * * * *

(26 U. S. C. 1946 ed., Sec. 23.)

Treasury Regulations 111, promulgated under the Internal Revenue Code:

> SEC. 29.23 (a)–1. *Business Expenses.*— Business expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business, except the classes of items which are deductible under sections 23 (b) to 23 (z), inclusive, and the regulations thereunder. Double deductions are not permitted. Amounts deducted under one provision of the Internal Revenue Code cannot again be deducted under any other provision thereof. * * *

STATEMENT

The Tax Court and the Court of Appeals found the facts as follows with respect to the single issue[1] raised on appeal:

Taxpayers are husband and wife, and were during the taxable years 1943 and 1944 engaged in the optical business under the trade name of City Optical Company in Wilmington, North Carolina, with branches in other North Carolina localities, and under the name of Richmond Op-

[1] Four other issues were decided by the Tax Court in taxpayers' favor. (14 T. C. 1066–1067). The Commissioner did not appeal from these adverse rulings.

tical Company in Richmond, Virginia. (R. 142.) Taxpayer Helen W. Lilly also conducted a similar business under the name of Duke Optical Company in Fayetteville, North Carolina. (R. 142, 184.)

The City Optical Company, in computing its net income, deducted the sum of payments in each year made to various physicians specializing in the care and treatment of the eye. These payments were described upon its books as "trade discounts". The basis for these payments was an agreement or understanding between such physicians and the City Optical Company that each physician, after performing service for his patient and prescribing proper lenses would, if possible, guide the patient to this particular optical company for the work of grinding the glasses and furnishing and fitting frames. Under these agreements the City Optical Company paid to the physician in each case one-third of the amount it charged his patient for the services performed by the optical company. No information was volunteered to the patient that payment was to be made by the optical company to the physician of any portion of the amount paid by him to the optical company for the service there rendered. If a patient asked whether any portion of his payment to the optical company would be paid over to the physician, he was told; but this occurred very rarely. (R. 142–143, 146, 153–155.) In practically every instance the

patient was unaware of the fact that his physician was receiving from the optical company a portion of his payment made to that company. (R. 143.)

The label "trade discounts", under which taxpayers recorded these payments in their books did not correctly describe them (R. 154–155), but camouflaged them (R. 154, 188). The payments to some of the oculists were made in cash at their request. (R. 155.) So far as disclosed by the record, the contracts between taxpayers and the doctors were oral. (R. 155.)

Patients were usually told by the physician that when their glasses were made and fitted by the optical company they should bring them back to the physician for him to check the quality and accuracy of the work done by the optical company and to see if they had been properly fitted. The work to be done by the physician on return to him by the patient might include a re-examination of the eyes of the patient, if such was required. All of these services to be rendered later by the physician were included in the charge made the patient by the physician and, accordingly, no additional charge was made for this service, whether the patient had the prescription filled by an optical company with which the physician had a so-called "kickback" arrangement or an optical company with which the physician had no such agreement. (R. 143, 146–147.)

The same agreements as to "trade discounts" were made and carried out under similar circum-

stances by taxpayer Helen W. Lilly, trading as Duke Optical Company, for 1943 and 1944. (R. 144, 184.)

Explanations by various witnesses at the hearing, as tending to jsutify the propriety of the arrangement between taxpayers and the physicians, were found by the Tax Court not to be convincing. (R. 146.): 1. No basis was found for the statement by some witnesses that the optician was considered as an agent or employee of the physician. The particular optician was selected by the patient, who was free to make any selection. (R. 146.) 2. In some cases oculist-physicians did their own "dispensing", that is, they not only measured vision and prescribed the lenses, but sent the prescription to some optical company for the grinding and fitting of the lenses to the type of frame selected by the patient, the measurements for which had been taken by the physician. On the return to the physician of the fitted lenses, they were adjusted by the physician to the patient and a total charge was made for the entire service. In these cases the practice was for the physician to charge his patient the fee for the service rendered and the retail price for the lenses and frames furnished by the optical company. The physician was then billed by and paid the optical company at the lower wholesale rate for the lenses and frames. (R. 144, 147.) The Tax Court found to be without basis in fact the explanation by some witnesses

that the surrender by the physician of the profit he thus would have made (if he had personally bought the lenses and frames and fitted the glasses) constituted consideration for and entitled him to receive a portion of the profit derived by the optician for that service. The employment by the patient of an optician to perform the service in question relieves the physician not only of the work of the fitting and adjusting glasses, but also of the burden of financing their manufacture and eliminates the possibility of loss to the physician through the patient's failing to pay for the glasses. (R. 147.)

The "kickback" practice tended to increase the cost of glasses to a patient. The oculist, in a relationship of great trust and confidence with respect to the patient, was subjected to the temptation of prescribing glasses where not actually necessary, or more expensive lenses than those really needed, and of recommending an inferior optician. The cost of glasses was artificially increased by the inclusion of the physician's commission, for which the physician afforded no consideration to the patient, and of which the patient was, in practically all cases, ignorant. (R. 153, 187.)

One of the two optical companies in Greensboro, North Carolina, a competitor of the City Optical Company, ceased its practice of paying these commissions or "kickbacks" to oculists subsequent to the taxable years and prior to the

hearings of the instant proceedings. (R. 144, 155.)

The practice of accepting so-called "kick-backs" from optical companies was frowned upon and considered unethical by the medical profession as a whole, and had been criticized and condemned at meetings of the medical associations and in their professional publications. (R. 143–144, 149.) The Medical Society of North Carolina—the state in which these taxpayers were chiefly engaged in business—had condemned the practice. (R. 144, 187–188.)

"Trade discounts" allowed oculist physicians by the City Optical Company for the three following years were (R. 144):

1942	[2] $57,063.45
1943	61,601.95
1944	60,021.65

"Trade discounts" allowed oculist physicians by Duke Optical Company for 1943 were $6,568.87, and for 1944 were $4,798.35. (R. 144.)

In determining deficiencies against taxpayers, the Commissioner disallowed these trade discounts as deductions (R. 1), and upon redetermination, in an opinion reviewed by the entire court (R. 158), the Tax Court sustained the Commissioner (R. 142–158), Judge Arundell dissenting (R. 158–160). Accordingly, the Tax

[2] Income for 1942 is relevant by reason of its effect on computation of the 1943 tax under the forgiveness features of the Current Tax Payment Act of 1943, c. 120, 57 Stat. 126, Sec. 6.

Court decided[3] that there were deficiencies in income taxes due from taxpayer Thomas B. Lilly for the years 1943 and 1944 in the amounts of $54,953.67 and $19,301.68, respectively (R. 160–161), and in the case of taxpayer Helen W. Lilly for the years 1943 and 1944 in the amounts of $26,685.29 and $23,167.14, respectively (R. 161).

Upon taxpayers' appeal, the court below unanimously affirmed the decision of the Tax Court (R. 183–188), holding that (R. 186):

> We certainly will not lend the force of any opinion of this court to sanction, as an "ordinary and necessary" expense of the optician's business, the making and carrying out of such unconscionable and reprehensible contracts for secret kickbacks to a doctor.

SUMMARY OF ARGUMENT

I

A. Petitioners, engaged in the business of making eyeglasses, seek to be allowed to deduct as "ordinary and necessary" business expenses, secret rebates paid by them to doctors who referred patients to them. Since allowance of a deduction depends upon legislative grace, petitioners may prevail only by bringing themselves clearly within the statutory provision. In construing the phrase "ordinary and necessary", it

[3] Certain other amounts, not herein issue, appear also to be included in the deficiencies, as found by the Tax Court. (14 T. C. 1067).

has become well established that a line must be drawn between "legitimate business expenses and those arising from that family of contracts to which the law has given no sanction." *Textile Mills Corp.* v. *Comm'r.*, 314 U. S. 326, 339. Stated more generally, the rule is that the taxing authorities and the courts will not lend their aid to illegal transactions by permitting tax deductions of expenses arising from activities which frustrate "sharply defined national or state policies proscribing particular types of conduct." *Commissioner* v. *Heininger*, 320 U. S. 467, 473.

B. The relationship of doctor to patient is a fiduciary one of the highest order. The secret kick-backs here involved had the purpose and effect of corrupting that relationship by giving the doctor an undisclosed financial stake in the manufacture of eyeglasses and in the referral of his patient to a particular optical company. Such an agreement is in plain violation of the doctor's fiduciary duties; the optical company which, by making the payment, seeks to corrupt the fiduciary relationship is equally guilty. Under settled judicial principles, the rebate agreement would be unenforcible by either party. Such agreements, moreover, offend applicable statutory policies of the states in which petitioners operated. The accepted professional standards of the medical profession as disclosed by the record and by official publications of the American Medical Asso-

ciation of which this Court can take judicial notice are in accordance with the foregoing principles. Medical associations have, both before and since the taxable years, explicitly and unequivocally condemned the practice of giving secret rebates disclosed by the present record. The rebating practice is also violative of state and federal antitrust laws. Its necessary effect, as the Tax Court held, is arbitrarily to fix and inflate the prices for eyeglasses. As a result of a federal antitrust consent decree entered in the Northern District of Illinois, leading eyeglass producers have agreed to abandon the practice.

C. The rebate payments were not merely incidentally related to the illegal scheme, they were its heart and center. On the findings below and the facts disclosed by the record, petitioners' participation in that scheme was deliberate and intentional; they granted the rebates because they understood and sought to corrupt the confidential relationship between physician and patient. Moreover, both parties to the agreements sought to conceal them from patients and petitioners sought to camouflage the payments on their books. Since the rules condemning such agreements are well settled and long established, there is no merit to petitioners' suggestion of unfair retroactivity in the decision below.

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II

Petitioners' assumption that the courts below found the payments to be ordinary and necessary in the usual sense of those words and denied the deductions solely on grounds of public policy is mistaken. There is no finding by either court that payments were ordinary or necessary in any sense; indeed, both courts found to the contrary. Proof that some optical companies engaged in the practice does not meet petitioners' burden of establishing that the payments were ordinary or necessary. The statutory phrase requires that the expense in question be measured against the "norms of conduct" (*Welch* v. *Helvering*, 290 U. S. 111, 114) of the business community generally. Only abysmal cynicism could pretend that this making of secret payments in corruption of a professional relationship of the utmost confidence is normal in American business life.

ARGUMENT

Petitioners, engaged in the business of making eyeglasses, seek by this proceeding to be allowed to deduct from their gross income secret rebates paid by them to doctors who referred their patients to them. Agreements to make such rebates are in clear violation of the well-established standards applicable to a fiduciary relationship

such as that of doctor to patient, of established professional standards of medical practice, and of state and federal antitrust laws. The practice of entering into such agreements is one which reputable doctors will not engage in; no showing has been made that it is accepted by optical companies generally. Broadly stated, the question presented is whether an optical company which does engage in the practice may deduct such rebates as "ordinary and necessary expenses paid * * * in carrying on any trade or business."

It is well settled that allowance of a deduction "depends upon legislative grace," and that "only as there is clear provision therefor can any particular deduction be allowed." *New Colonial Co.* v. *Helvering*, 292 U. S. 435, 440; *White* v. *United States*, 305 U. S. 281, 292; *Deputy* v. *duPont*, 308 U. S. 488, 493; *City Ice Delivery Co.* v. *United States*, 176 F. 2d 347, 350 (C. A. 4).

The statutory provision on which petitioners base their claim is Section 23 (a) (1) (A) of the Internal Revenue Code (*supra*), allowing deduction for "ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business." In order to prevail here, they must bring themselves clearly within that provision.

Section 23 (a) (1) (A) does not authorize deduction of all business expenses incurred or paid during the taxable year. In order to be deductible the expense must be "ordinary and neces-

sary." The phrase is in the conjunctive; both requirements must be satisfied. "Congress has not decreed that all necessary expenses may be deducted. Though plainly necessary they cannot be allowed unless they are also ordinary." *Deputy* v. *duPont, supra,* p. 497; see also *Welch* v. *Helvering,* 290 U. S. 111, 113.

These statutory tests do not admit of any rule-of-thumb application. As Mr. Justice Cardozo said, in *Welch* v. *Helvering, supra,* p. 115:

> The standard set up by the statute is not a rule of law; it is rather a way of life. Life in all its fullness must supply the answer to the riddle.

Both the Treasury and the courts have had repeated occasion to define and apply these tests, as here, to a particular state of facts. *Welch* v. *Helvering, supra,* 290 U. S. at 116; *Deputy* v. *duPont, supra,* 308 U. S. at 496; *Textile Mills Corp.* v. *Commissioner,* 314 U. S. 326; *Commissioner* v. *Heininger,* 320 U. S. 467; *McDonald* v. *Commissioner,* 323 U. S. 57; *City Ice Delivery Co.* v. *United States, supra,* p. 350. This Court has stated that the question whether an expense is ordinary and necessary is generally a question of fact and that "each case should depend upon its peculiar circumstances." *Commissioner* v. *Heininger, supra,* 320 U. S. at 473. It has pointed out that the Commissioner's ruling has the support of a presumption of correctness. *Welch* v. *Helvering, supra,* 290 U. S. at 115. And it has

repeatedly declared that on such issues as this it will pay great deference to the expert judgment of the Tax Court. E. g., *Commissioner* v. *Heininger, supra,* 320 U. S. at 475; *McDonald* v. *Commissioner, supra,* 323 U. S. at 64.[4]

We believe that petitioners have failed to establish their right to the claimed deductions, and that the Commissioner's ruling, approved by the Tax Court sitting *en banc* and the unanimous court below, should be sustained. In the following portions of this brief we shall demonstrate, *first,* that compelling considerations of public policy require that the practice of entering into "such unconscionable and reprehensible contracts for secret kickbacks" (R. 186) in violation of well-established judicial and professional standards should not be assisted by allowance of tax deductions for payments made pursuant to such contracts, and, *second,* that even apart from such considerations of public policy, the kickbacks here involved have not been shown to be ordinary

[4] This principle of respect for the expert judgment of the Tax Court on questions of the application of a broad general standard to a myriad variety of particular factual situations is based on the view that a court which can deal only intermittently and occasionally with the manifold applications of such a statutory test should be reluctant to overturn the considered judgment of a tribunal which has continuing daily contact with such issues. That principle has special force where, as here, the decision of the Tax Court was reviewed by the entire Court and approved with but a single dissent.

or necessary to the carrying on of the optical business.

I

Compelling considerations of public policy preclude allowance of the deduction here claimed

A. *Expenses arising out of agreements which are illegal, or which frustrate sharply defined national or state policies, may not be deducted.*— Many decisions settle that when Congress, in the exercise of its favor, permitted deduction of "ordinary and necessary" business expenses, it did not mean to include expenses whose allowance would assist through tax consequences in the financial success of activities denounced in the states where the revenue laws operate, or condemned under federal law. Congress must not be regarded as legislating in a vacuum. The rule has been evolved that no deduction should be allowed as "ordinary and necessary" which "frustrates sharply defined national or state policies proscribing particular types of conduct", *Commissioner* v. *Heininger, supra,* 320 U. S. at 473; "in the nature of things, public policy must narrow the field of allowable deductions which rest as they do upon legislative indulgence." *National Brass Works* v. *Commissioner,* 182 F. 2d 526, 530 (C. A. 9). Moreover, it can hardly be supposed that in limiting deductions to expenses which are "ordinary and necessary" Congress contemplated that deliberate violation of law is

ever a necessary or an ordinary activity of business men (*ibid*).

Nor is there any lack of logic in taxing income from illegal sources (*United States* v. *Sullivan*, 274 U. S. 259; see also *United States* v. *Rutkin*, 189 F. 2d 431 (C. A. 3), pending on certiorari, No. 195, this Term) and refusing a deduction for expenses resting in illegality. This result was sustained in *Cohen* v. *Commissioner*, 176 F. 2d 394, 397, 400–401 (C. A. 10), where both types of taxpayers were involved. See also *Silberman* v. *Commissioner*, 44 B. T. A. 600, 603–604. The broad definition of income under Internal Revenue Code, Section 22 (a), covers gains or profits on income from any source whatsoever; on the other hand, the privilege of deducting business expenses is strictly limited to expenses which are "ordinary and necessary."[*]

Accordingly, the Treasury, the Tax Court and the federal courts have repeatedly drawn a line between "legitimate business expenses and those arising from that family of contracts to which the law has given no sanction." *Textile Mills Corp* v. *Commissioner*, 314 U. S. 326, 339. In that case, in upholding the validity of an interpretative Treasury Regulation defining the words "ordinary and necessary" as excluding certain

[*] Thus, legitimate expenses of an illegal business are deductible, but expenditures made in carrying on activities which are in themselves in contravention of law are not deductible as business expenses. *Cohen* v. *Commissioner*, *supra*, p. 400; *Silberman* v. *Commissioner*, *supra*, p. 603–604.

types of lobbying expenses, this Court, in words equally applicable to the present case, said (pp. 338–339):

> Petitioner's argument that the regulation is invalid likewise lacks substance. The words "ordinary and necessary" are not so clear and unambiguous in their meaning and application as to leave no room for an interpretative regulation. The numerous cases which have come to this Court on that issue bear witness to that. *Welch* v. *Helvering*, 290 U. S. 111; *Deputy* v. *duPont*, 308 U. S. 488, and cases cited. Nor has the administrative agency usurped the legislative function by carving out this special group of expenses and making them nondeductible. We fail to find any indication that such a course contravened any Congressional policy. Contracts to spread such insidious influences through legislative halls have long been condemned. *Trist* v. *Child*, 21 Wall. 441; *Hazelton* v. *Sheckells*, 202 U. S. 71. Whether the precise arrangement here in question would violate the rule of those cases is not material. The point is that the general policy indicated by those cases need not be disregarded by the rule-making authority in its segregation of non-deductible expenses. There is no reason why, in absence of clear Congressional action to the contrary, the rule-making authority cannot employ that general policy in drawing a line between *legitimate* business expenses and *those arising from that family of contracts to*

> *which the law has given no sanction.* The exclusion of the latter from "ordinary and necessary" expenses certainly does no violence to the statutory language. The general policy being clear it is not for us to say that the line was too strictly drawn. [Italics supplied.][5]

That decision was approved in *Commissioner v. Heininger, supra,* in which this Court again recognized that (320 U. S. at 473):

> The Bureau of Internal Revenue, the Board of Tax Appeals, and the federal courts have from time to time, however, narrowed the generally accepted meaning of the language used in § 23 (a) in order that tax deduction consequences might not frustrate sharply defined national or state policies proscribing particular types of conduct.

This principle has been applied to a wide variety of situations. Some examples of its application are the following:

Textile Mills Corp. v. Commissioner, supra (expenses incurred for certain types of lobbying and political pressure activities with a view to influencing federal legislation); *Rugel v. Commissioner,* 127 F. 2d 393, 395 (C. A. 8th) (payments to an influential party precinct captain in

[5] Although the *Textile Mills* case involved an interpretative regulation, the principles which it approved may, in the absence of regulation, properly be applied by the courts. Indeed, none of the other cases cited on this and the following pages rested on the language of any regulation.

order to obtain a state printing contract); *Harden M. Loan Co.* v. *Commissioner,* 137 F. 2d 282, 284 (C. A. 10th) (payments for exerting political influence made under the guise of selling commissions on road-building materials); *Cohen* v. *Commissioner,* 176 F. 2d 394, 400–401 (C. A. 10th) (payments for protection afforded gambling establishments against raid and arrest by law enforcement officers); *Excelsior Baking Co.* v. *United States,* 82 F. Supp. 423 (D. Minn.) (large sums paid surreptitiously to disreputable men to negotiate a labor contract concealed by deceptive entries in taxpayer's books); *Kelley-Dempsey & Co.* v. *Commissioner,* 31 B. T. A. 351 (expense of commercial extortion); *Easton Tractor & Equipment Co.* v. *Commissioner,* 35 B. T. A. 189 ("commissions" paid for personal influence in obtaining public contracts); *Kyne* v. *Commissioner,* 35 B. T. A. 202 (amounts expended in promoting legislation which would legalize horse racing); *Nicholson* v. *Commissioner,* 38 B. T. A. 190, 198–199 (payments, amounting to one-third of the profit, made to a state senator for his political influence in obtaining favorable conditions covering the bidding on a public contract); *Maddas* v. *Commissioner,* 40 B. T. A. 572, 581–582, affirmed on another ground, 114 F. 2d 548 (C. A. 3d) (bribes paid prohibition officers to secure immunity from prosecution); *Silberman* v. *Commissioner,* 44 B. T. A. 600 (expenditures for use of booths and for services of persons registering

bets, activities which in themselves contravened state law); *Weather-Seal Mfg. Co.* v. *Commissioner*, 16 T. C. 1312, pending on appeal (C. A. 6th) (wages paid in contravention of Federal Wage Stabilization Law and Executive Order promulgated thereunder); *Reliable Milk & Cream Co.* v. *Commissioner*, decided August 20, 1938 (1938 P-H B. T. A: Memorandum Decisions, par. 38,290) (payments made to racketeers under fear of assault of milk dealers and burning of trucks); *Giubbini* v. *Commissioner*, decided October 27, 1939 (1939 P-H B. T. A. Memorandum Decisions, par. 39,471) (sums paid drugstore for referring clients to an abortionist); *Lewis* v. *Commissioner*, decided April 17, 1941 (1941 P-H B. T. A. Memorandum Decisions, par. 41,228) (sums paid for private information enabling taxpayer to become the low bidder on a grading job of the payee's employer); *Barlow* v. *Commissioner*, decide May 19, 1943 (1943 P-H T. C. Memorandum Decisions, par. 43,237) (attorney's fees in excess of ten per cent limit fixed by a private act appropriating an award of the Court of Claims).

On the same reasoning, fines and penalties paid to the national or state governments are not comprehended within the meaning of "ordinary and necessary" business expenses since their allowance would, by way of a tax advantage, constitute a partial remission, thus circumventing the public policy pursuant to which the sanctions are imposed. *Great Northern Ry. Co.* v. *Commis-*

sioner, 40 F. 2d 372 (C. A. 8th), certiorari denied, 282 U. S. 855; *Burroughs Bldg. Material Co.* v. *Commissioner*, 47 F. 2d 178 (C. A. 2d); *Chi. R. I. & P. Ry. Co.* v. *Commissioner*, 47 F. 2d 990, 991 (C. A. 7th), certiorari denied, 284 U. S. 618; *Tunnel R. R.* v. *Commissioner*, 61 F. 2d 166, 173-174 (C. A. 8th), certiorari denied, 288 U. S. 604; *National Outdoor Advertising Bureau* v. *Helvering*, 89 F. 2d 878, 881 (C. A. 2d); *Standard Oil Co.* v. *Commissioner*, 129 F. 2d 363 (C. A. 7th); *Helvering* v. *Superior Wines & Liquors*, 134 F. 2d 373 (C. A. 8th), certiorari denied, 317 U. S. 688; *Commissioner* v. *Longhorn Portland Cem. Co.*, 148 F. 2d 276 (C. A. 5th), certiorari denied, 326 U. S. 728; *Universal Atlas Cement Co.* v. *Commissioner*, 171 F. 2d 294 (C. A. 2d), certiorari denied, 336 U. S. 962; *Jerry Rossman Corp.* v. *Commissioner*, 175 F. 2d 711, 713 (C. A. 2d); *National Brass Works* v. *Commissioner*, 182 F. 2d 526 (C. A. 9th), on remand to Tax Court, 16 T. C. 1051, pending an appeal from remand; *Scioto Provision Co.* v. *Commissioner*, 9 T. C. 439; *Garibaldi & Cuneo* v. *Commissioner*, 9 T. C. 446; *Henry Watterson Hotel Co.* v. *Commissioner*, 15 T. C. 902, pending on appeal (C. A. 6th).

Petitioners, in effect, ask that this "so-called doctrine of public policy" (Brief, pp. 6, 15),

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[*] The English courts have reached similar results in applying the cognate provisions of the British Income Tax Acts. See *Inland Revenue Commissioners* v. *Von Glehn* [1920] 2 K. B. 553; *Inland Revenue Commissioners* v. *Warnes & Co.*, [1919] 2 K. B. 444.

thus approved and applied by this Court and by innumerable decisions of the Tax Court and courts of appeals, should be overruled. They urge that the rule is in "plain disregard of the language" of Section 23 (a) (1) (A) (Brief, p. 6; see also p. 16) and "cannot be adequately justified" (Brief, p. 6). They apparently seek a holding that the Commissioner may not "deny deductions on the basis of public policy." (Brief, p. 7.) Their argument in this respect has two branches, *first*, that Section 23 (a) (1) (A) is concerned solely with net income, so that any denial of deduction for an expense actually paid or incurred contravenes the statute (Brief, pp. 8–15), and *second*, that experience has established that the public policy rule as applied to business deductions is unsatisfactory if not unworkable (Brief, pp. 15–25).

The first branch of their argument ignores the fact that Congress did not authorize deduction of every business expense paid or incurred, but only of such expenses paid or incurred as were "ordinary and necessary." There can be no doubt that "Congress has power to condition, limit or deny deductions from gross income in order to arrive at the net that it chooses to tax." *Helvering* v. *Ind. Life Ins. Co.*, 292 U. S. 371, 381. As Mertens states (1 Mertens, *Law of Federal Income Taxation*, Sec. 5.10, pp. 186–187):

> The courts have repeatedly viewed deductions as matters of legislative grace, so that

> "net income" becomes a statutory rather than an economic concept under which items which might be considered as gross income by the business man are treated as taxable income by statute.

Again, the same writer comments with respect to language in Treasury Regulations 111, Sec. 29.21–1, referred to by petitioners (Brief, p. 9) (2 Mertens, *Law of Federal Income Taxation*, Sec. 12.04, pp. 127–128):

> The regulations provide that the taxpayer's method of accounting will be used *if* "the method so used is properly applicable in determining the net income of the taxpayer for purposes of taxation." Similarly, in dealing with the definition of taxable net income, the Treasury throws out a warning that such income "is a statutory conception" but adds the suggestion that it follows commercial usage except as to exemptions and as to deductions for partial losses. However, it frequently does not follow such usage; taxable income includes many items which are not ordinarily so considered and the statute either disallows entirely or materially limits the deduction of many disbursements considered ordinarily, in common accounting practice, as expenses or losses.

Indeed, the courts have repeatedly sustained treatment as taxable net income of items which might be considered commercially as gross income, in *Stanton* v. *Baltic Mining Co.*, 240 U. S. 103, 113 (depletion deduction); *Helvering* v. *Ind. Life*

Ins. Co., supra (depreciation deduction); *Philadelphia Fire & Marine Ins. Co.* v. *United States*, 3 F. Supp. 655 (C. Cls.), certiorari denied, 290 U. S. 703 (limitation on net losses); *Phipps* v. *Bowers*, 49 F. 2d 996 (C. A. 2d), certiorari denied, 284 U. S. 641 (interest deduction). The circumstance that the income tax system is based on annual accounting periods may also result in taxation of gross income in a sense. *Burnet* v. *Sanford & Brooks Co.*, 282 U. S. 359; *Spring City Co.* v. *Commissioner*, 292 U. S. 182, rehearing denied, 292 U. S. 613.

Petitioners seek support for their contention from congressional debates of some thirty-eight years ago (Br. 11–13), with respect to the language of the loss deduction, as enacted in the Income Tax Act of 1913, c. 16, 38 Stat. 114, 166, Sec. II, B and G (b). As a matter of fact, loss deductions have been denied when incurred in commission of acts forbidden by law. See *Wagner* v. *Commissioner*, 30 BTA 1099; *Anderson* v. *Commissioner*, 35 BTA 10.[7] Moreover, the rigor-

[7] See Revenue Act of 1934, c. 277, 48 Stat. 680, Sec. 23 (g), now Internal Revenue Code, Sec. 23 (h), whereby wagering losses were limited to the extent of wagering gains. In proposing this provision the House Committee explained this amendment (H. Rep. No. 704, 73d Cong., 2d sess., p. 22 (1939–1 Cum. Bull. (Part 2) 554, 570)):

"Section 23 (g), Wagering losses: Existing law does not limit the deduction of losses from gambling transactions where such transactions are legal. Under the interpretation of the courts, illegal gambling losses can only be taken to the extent of the gains on such transactions. A similar limitation on losses from legalized gambling is provided for in the

ous requirements that expenses, to be deductible, must be "ordinary and necessary" does not apply to losses. Internal Revenue Code, Section 23 (e); 5 Mertens, *supra*, Sec. 28.37. Finally, taxpayers' argument based on this distant floor discussion asks this Court, in effect, to repudiate its holdings and reasoning in the *Textile Mills* and *Heininger* cases, *supra*, and numerous lower court decisions. Congress must be presumed to have known during the past thirty-eight years of the repeated administrative and judicial construction of the business expense deduction provision, but significantly made no change in its terms.[8]

The second branch of their argument comes to little more than an assertion that denial of business expense deductions on grounds of public policy could lead to undesirable results if pushed too far, and that in close cases the courts, applying the rule, have on occasion reached results either inconsistent or difficult to reconcile. This case, however, does not by any conceivable stretch of the imagination involve the question whether the Commissioner may "pass upon the social desirabil-

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bill. Under the present law many taxpayers take deductions for gambling losses but fail to report gambling gains. This limitation will force taxpayers to report their gambling gains if they desire to deduct their gambling losses."

[8] Certainly there can be no basis for a suggestion that the present Congress is more willing than the courts have been to confer tax benefits on illegal activities. On the contrary, the present tendency is in the opposite direction. See e. g., the recommendations of the Kefauver Committee, S. Rep. 307, 82d Congress, 1st sess., pp. 11–12.

ity of business outlays" and "evince his displeasure" by denying a deduction. (Pet. Br. p. 8). As this Court pointed out in *Commissioner* v. *Heininger, supra*, denial of business deductions on public policy grounds is limited to cases of violation of "sharply defined national or state policies." It is because the payments here involved clearly violate state and federal policies which have been sharply defined, and which were so defined prior to the taxable years, that their deduction has been denied. As we shall show (Pt. B, *infra*) the unconscionable and reprehensible character of the agreements pursuant to which these secret kickbacks were made is beyond question. For the same reason, the asserted difficulties in applying the public-policy doctrine to cases of doubtful illegality have no bearing. In any event, we believe those difficulties are no more than inevitably arise in the application of a legislative test phrased in terms of such generality as "ordinary and necessary." Indeed, the decisions applying this phrase in areas involving no question of public policy (e. g. *Welch* v. *Helvering, supra*; *McDonald* v. *Commissioner, supra*) present problems at least equally difficult of solution. Compare *Jordan* v. *De George*, 341 U. S. 223, 229–232.

In any event, what petitioners disparagingly refer to as the "so-called doctrine of public policy" has been well settled for many years, during which the provision permitting deduction of only such business expenses as are "ordinary and

necessary" has been repeatedly reenacted. At least in the absence of a most compelling showing that the rule is unsound, we believe it is for Congress, not the courts, to change the settled construction of the statutory phrase.

In addition to attacking root, stalk and branch, the rule approved in the *Textile Mills* and *Heininger* cases, petitioners seek to limit its scope in a way not heretofore approved by this Court and unsupported by decisions of other courts. Thus, while grudgingly conceding that "a doctrine of public policy might in some cases properly apply where a federal statute has been violated" (Br. p. 21) they in effect urge that it has no application to violations of state statutes, or of non-statutory policy whether federal or state. As we shall point out (infra, pp. 29–49) the agreements under which these payments were made violate federal as well as state statutes, and statutory as well as non-statutory policies. But in any event, the limitation which petitioners suggest has been clearly rejected by this Court. In the *Heininger* case, *supra,* this Court was careful to describe the rule as applicable to "national or state policies proscribing particular types of conduct." (320 U. S. at 473.) And its decision in the *Textile Mills* case denying a deduction for lobbying expenses rested, not on statute, but on judicial decisions condemning contracts of the general type involved. In holding that deductions could be denied for payments "arising from that family of

contracts to which the law has given no sanction" (314 U. S. at 339), it plainly intended to include contracts of all kinds whose performance is inconsistent with public policy. See also cases cited, *supra*, pp. 19–21.

B. The kick-back agreements here disclosed offend a number of sharply defined and long established judicial and legislative policies

1. *Under settled legal principles the kick-back agreements are illegal and void as in plain conflict with the fiduciary relationship of a doctor to his patient.*—"The relationship of patient and physician is to the highest possible degree a fiduciary one, involving every element of trust and confidence." Stryker, Courts and Doctors (1932), p. 9. Accordingly, that relationship is governed by the standards expressed by Judge Cardozo in *Meinhard* v. *Salmon*, 249 N. Y. 458, 464:

> Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate.

It is by that exacting "way of life" (*Welch* v. *Helvering*, *supra*, 290 U. S. at 115) that the present agreements must be judged.

Even as to mere agents the controlling rule is stated in 6 Williston on *Contracts* (Rev. ed.), Sec. 1737, p. 4905:

> A bargain by an agent, even though acting as such without compensation, to receive without his principal's consent compensation from others for the performance of his agency is invalid.

Moreover, as Williston further points out (p. 4906), probably any bargain, for reward, to influence by apparently disinterested advice the conduct of a third person is obnoxious to public policy, even when neither party at the time bears a fiduciary relation to the person to be influenced. He elaborates the principle as follows (pp. 4906–4907, fn. 10):

> The rule relating to a bargain to influence the conduct of a third person by apparently disinterested advice may be summarized thus: a fiduciary owes a double duty, to disclose his own interest in inducing action by the principal, and whatever he knows bearing on the proposed action; one not a fiduciary owes to one whom he seeks to influence a single duty, to disclose his interest in inducing action. A contract to violate the duties or duty so raised is contrary to public policy and invalid. * * *
>
> *Clearly an agreement, for a secret consideration, to influence one with whom the promisor stands in a confidential relation is illegal* [citing cases]; *or to influence one*

who may consult him in a confidential relation, * * *. [Italics supplied.]

To the same effect, see 2 Restatement, Contracts, Sec. 570.

This principle that one cannot at the same time serve two incompatible masters has been applied in innumerable decisions. *Mosser* v. *Darrow,* 341 U. S. 267; *City of Findlay* v. *Pertz,* 66 Fed. 427, 434 (C. A. 6th); *Reilly* v. *Beekman,* 24 F. 2d 791 (C. A. 2d); *Wolfe* v. *International Reinsurance Corp.,* 73 F. 2d 267 (C. A. 2d), certiorari denied, 294 U. S. 725; *Maryland Trust Co.* v. *National Mechanics Bank,* 102 Md. 608; *Humphrey* v. *Eddy Transportation Co.,* 107 Mich. 163; *Kelley-Dempsey & Co.* v. *Commissioner, supra; Easton Tractor & Equipment Co.* v. *Commissioner, supra.* Statutes alone have never determined public policy and the courts traditionally also have established rules proscribing conduct as against the public welfare.[9] There is

[9] In *Hurd* v. *Hodge,* 334 U. S. 24, 34–35, this Court said: "The power of the federal courts to enforce the terms of private agreements is at all times exercised subject to the restrictions and limitations of the public policy of the United States as manifested in the Constitution, treaties, federal statutes, and applicable legal precedents. Where the enforcement of private agreements would be violative of that policy, it is the obligation of courts to refrain from such exertions of judicial power."

"* * * violations of obvious ethical or moral standards" may provide a "plain indication" of "dominant public policy." *Muschany* v. *United States,* 324 U. S. 49, 66–67.

In Winfield, *Public Policy In The English Common Law,* 42 Harv. L. Rev. 76 (1928), the author states (p. 97):

nothing novel or nebulous about the well-settled rule applicable here, which proscribes as illegal bargains such as that between taxpayers and the physicians.

Thus, expressing the principle here governing the Court of Appeals for the Second Circuit said in *Reilly* v. *Beekman, supra,* at 794:

> It cannot be disputed that, if Reilly was in a fiduciary relation to Mrs. Trenkman when he recommended Beekman to her as her attorney, he could not agree to profit from the business arising out of the introduction without her knowledge and consent. This is because Mrs. Trenkman was entitled to his disinterested advice as to the attorney to be recommended to her. That advice was not likely to be disinterested, if affected by the consideration of whether or not he could make a profit out

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"But the better view seems to be that the difficulty of discovering what public policy is at any given moment certainly does not absolve the bench from the duty of doing so. The judges are bound to take notice of it and of the changes which it undergoes, and it is immaterial that the question may be one of ethics rather than of law. The basis for their decision is 'the opinions of men of the world, as distinguished from opinions based on legal learning.' Of course it is not to be expected that men of the world are to be subpoenaed as expert witnesses in the trial of every action raising a question of public policy. It is the judges themselves, assisted by the bar, who here represent the highest common factor of public sentiment and intelligence."

At another point, the author defines public policy as (p. 92) "a principle of judicial legislation or interpretation founded on the current needs of the community."

of the recommendation of a particular person. Moreover, she was entitled to have him recommend an attorney, the amount of whose fees would depend on the services he had to perform, and would not be affected by what he had to pay out to the plaintiff for an introduction to the client. *Auerbach* v. *Curie,* 119 App. Div. 176, 104 N. Y. S. 233; *Alpers* v. *Hunt,* 86 Cal. 78, 24 P. 846, 9 L. R. A. 483, 21 Am. St. Rep. 17; *McNair* v. *Parr,* 177 Mich. 327, 143 N. W. 42. If she knew Reilly's interest, and what he was to receive, and consented to the arrangement, the case would be different. She might be willing to sanction it, because it would save her from paying Reilly for his advice, or for other reasons. If, as is contended, Reilly was not acting in an ordinary sense as an agent for Mrs. Trenkman in respect to her business and financial affairs, and simply as a friend recommended a lawyer, when requested so to do, we think he stands in no better position. To be sure, in that case he would be only a volunteer; but if he offered merely as a friend to recommend an attorney, with no knowledge on her part that he was to derive any benefit from the recommendation, she was deprived of the disinterested advice which he assumed to give when he was under the pay of Beekman in making the recommendation.

This fundamental common law principle of public policy proscribing the corruption of an agent or fiduciary is particularly applicable here,

where not merely an ordinary commercial transaction is in question, but the fiduciary physician-patient relationship, entitling the patient to rely with the highest degree of confidence and trust on the disinterestedness of his physician. Even though the secret payment actually results in no damage to the patient, or even if the physician acted in good faith, public policy condemns the arrangement. The law proscribes all temptation for a fiduciary to be influenced by his own interest to the detriment of his principal. *Mosser* v. *Darrow*, 341 U. S. 267; *City of Findlay* v. *Perts*, *supra*, p. 434; see also authorities cited in the opinions below, R. 150–151, 186.

Here, as the courts below found, the kick-back practice obviously invites serious evils (R. 153, 187): (1) the prescription of glasses where not actually necessary; (2) the prescription of more expensive lenses than really needed; (3) the recommendation of an inferior optician; and (4) an artificial increase in the cost of the glasses by the inclusion of the physician's commission, for which the physician affords no value to the patient.[10] The bait of the secret consideration, which taxpayers offered, hopelessly divides the trusted confidant's interest. See *Lieberman* v. *State Board*

[10] See respondent's Exhibit T (R. 162–180), complaint in anti-trust suit brought by the United States against American Optical Company and a number of physicians, discussed below (pp. 47–49), and final judgment on consent against defendants entered in that action on May 16, 1951, subsequent to the decision below (Appendix B, *infra*, pp. 83 *et seq.*).

of Examiners in Optometry, 130 Conn. 344, 350–351.

These principles, moreover, reach not only the physician who violates his fiduciary obligations but also the taxpayers who induced and procured such violation, and who thereby participated directly in the corruption of the fiduciary relationship. Contrary to taxpayers' argument (Br. 27), the corrupt agreements were illegal and contrary to public policy for all purposes, not merely in the sense that the physician would not be able to recover upon them. The law inhibits in every respect their making and carrying out. Under established rules of contract, agency and trust, the patients could have recovered the rebates from either taxpayers or the physicians; the opticians could not have recovered back the rebates from the physicians. Restatement, *Restitution*, Sec. 138; Restatement, *Contracts*, Sec. 598.

The judicial rules prohibiting such agreements are thus well settled and of long standing. But it is not necessary to rely on judicial rules for the same public policy has been expressed in legislation. Under familiar criminal statutory provisions, common to many states, the giving of consideration to an agent with intent to influence his action in relation to his principal's business constitutes a misdemeanor. Such statutes were in effect during the taxable years in the states in which petitioners operated. 1 General Statutes of North Carolina (1943), Sec. 14–353; Virginia

Code of 1942, Annotated, Sec. 4712. Thus, commercial bribery is prohibited under criminal sanction in ordinary business transactions. While the present agreements may or may not fall technically within the letter of these statutory provisions, they are plainly violative of the policies which the statutes reflect.[11]

Indeed, several states have expressly declared the practices here shown to be a misdemeanor, both as to the payor and recipient of such commissions. Such provisions have been adopted by the States of Washington[12] and Califor-

[11] The Government does not suggest that the mere existence of a state law, prohibiting a particular transaction or relationship, is determinative of the question of deductibility. It is not a particular law, but the broader public policy that is crucial. That policy may, of course, be evidenced by state laws pointing in one general direction.

[12] Remington's Revised Statutes of Washington, Annotated (1949 Supp.):

"§ 10185–14. *Rebates for referral of patients unlawful.*—It shall be unlawful for any person * * * to pay, or offer to pay or allow, directly or indirectly, to any person licensed by the State of Washington to engage in the practice of medicine and surgery, * * * and it shall be unlawful for such person to request, receive or allow, directly or indirectly, a rebate, refund, commission, unearned discount or profit by means of a credit or other valuable consideration in connection with the referral of patients to any person, firm, corporation or association, or in connection with the furnishings of medical, surgical or dental care, diagnosis, treatment or service, on the sale, rental, furnishing or supplying of clinical laboratory supplies or services of any kind, or any other goods, services or supplies prescribed for medical diagnosis, care or treatment.

"Any person violating the provisions of this section is guilty of a misdemeanor. [L. '49, ch. 204, § 1.]"

nia.[13] And recent legislation of North Carolina, where taxpayers principally operated, providing for regulation and licensing of dispensing opticians, has expressly forbidden the practice and imposed criminal penalty on any optical company engaging in it.[14]

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[13] California Business and Professions Code (Deering, 1949 Pocket Supp.):

"§ 650. *Rebates, etc. for referral of patients, clients and customers unlawful.*—The offer, delivery, receipt or acceptance, by any person licensed under this division of any unearned rebate, refund, commission, preference, patronage dividend, discount, or other unearned consideration, whether in the form of money or otherwise, as compensation or inducement for referring patients, clients, or customers to any person, irrespective of any membership, proprietary interest or co-ownership in or with any person to whom such patients, clients or customers are referred is unlawful. [Added by Stats. 1949, ch. 899, § 1.]

"§ 652. *Violation of article to constitute unprofessional conduct and grounds for suspension or revocation of license: Conduct of proceedings: Misdemeanor.*—* * * In addition, any violation constitutes a misdemeanor as to any and all persons offering, delivering, receiving, accepting or participating in any such rebate, refund, commission, preference, patronage dividend, unearned discount or consideration, whether or not licensed under this division. [Added by Stats. 1949, ch. 899, § 1.]"

[14] North Carolina Session Laws (1951), c. 1089, Secs. 21, 23:

"Sec. 21. Any person, firm or corporation who shall violate any provision of this Act for which no other penalty has been provided shall, upon conviction, be fined not more than two hundred ($200.00) dollars or imprisoned for a period of not more than twelve (12) months, or both, in the discretion of the court.

2. The obnoxious nature of such agreements has been repeatedly recognized by the medical profession.

These conclusions, drawn from judicially created standards applicable to all fiduciaries, are confirmed by standards repeatedly insisted upon by the medical profession itself. The accepted standard of medical practice is far from being as low as the burden of petitioners' argument would imply. The tribunals below found (R. 144, 187–188) that the disputed practice was considered unethical by the medical profession as a whole and had been criticized and condemned at meetings of medical societies and in professional publications. It had been condemned by the Medical Society of North Carolina, although no direct action had been taken by that society against any individual physician.

In addition, this Court may properly take judicial notice of authoritative pronouncements by the American Medical Association and by the Chairman of its section on Ophthalmology, as evidencing the standards approved by that body

(Continued)

"SEC. 23. It shall be unlawful for any person, firm or corporation to offer or give any gift or premium or discount, directly or indirectly, or in any form or manner participate in the division, assignment, rebate or refund of fees or parts thereof or to engage in advertising in any form or manner that would urge the public to seek the services of any specific professional person or group of persons engaged in the field of refraction and visual care."
(In effect April 14, 1951.)

as norms of professional conduct. Cf. *Muller* v. *Oregon*, 208 U. S. 412, 419–421; *Parker* v. *Brown*, 317 U. S. 341, 363–366; *H. J. Heinz Co.* v. *Labor Board*, 311 U. S. 514, 523–525; *Universal Camera Corp.* v. *Labor Bd.*, 340 U. S. 474, 494. Those pronouncements leave no doubt that authoritative medical opinion condemns such arrangements on essentially the same grounds as those reflected in the governing judicial standards referred to above. For the convenience of the Court we have reprinted in "Appendix A" (*infra* pp. 59–82) a number of excerpts from published statements from the foregoing sources bearing on the point;[15] we shall refer here to only a few of the most significant.

Thus, the Principles of Medical Ethics of the American Medical Association (1943) expressly declares, "It is unprofessional to accept rebates on prescriptions or appliances, * * *." Art. I, Sec. 5 (p. 60, *infra*). The 1949 revision of the

[15] The material contained in Appendix A, *infra*, consists of excerpts from Principles of Medical Ethics of the American Medical Association (pp. 59–63, *infra*); an address read before the Section on Ophthalmology of the American Medical Association by its chairman at the annual session of the Association in 1941, published in the American Medical Journal (pp. 63–74, *infra*), and editorials published in the American Medical Journal in 1946 and 1948, the last being formally signed by the Association's officers and trustees (pp. 75–82, *infra*). Appendix A, with the exception of the excerpt marked "II", pp. 62–63, *infra*, was before the court below, and some of the materials contained in it were referred to by the court below (R. 187).

Principles of Medical Ethics repeats this statement and adds (Chapter I, Sec. 6; pp. 62–63, *infra*) that the physician

> * * * should receive his remuneration for professional services rendered *only in the amount of his fee specifically announced to his patient* at the time the service is rendered or in the form of a subsequent statement, and he should not accept additional compensation *secretly or openly, directly or indirectly, from any other source.* [Italics supplied.]

A leading article in the Journal of the American Medical Association for August 16, 1941 (117 J. A. M. A. 497–499), by Dr. Albert C. Snell, Chairman of the Section on Ophthalmology of that Association, entitled "Some Principles of Medical Ethics Applied to the Practice of Opthalmology," and stated to have been read at the Ninety-Second Annual Session of the Association in June, 1941, pp. 63–74, *infra*, discusses the application of the Association's code of medical ethics to the secret commission or rebate practice here under consideration. Dr. Snell describes the precise practice revealed by the present record and states as to it (p. 72, *infra*):

> There can, of course, be no justification whatever for the receiving of a percentage rebate for glasses which are furnished by opticians who provide all the services connected with the supplying of glasses. This practice violates every ethical medical

principle of practice. Under these circumstances the patient either receives an inferior quality of product or an inferior optical service.

He concludes his discussion with the following (pp. 73–74, *infra*):

> It seems to me that the *crux* of unethical practices *lies primarily in some secret form of rebate,* differential or *kick-back*—to some *furtive* participation in the profits connected with the supplying of lenses and their mountings, *which participation is done without the knowledge of the patient.* As a consequence of this method of practice, patients are compelled to pay for services which are not rendered either by the ophthalmologist or by the optician. Evidently this practice does not consider the best interest of the patient.
>
> When an adequate and proper fee is made for the professional services rendered, the ophthalmologist is not ethically entitled to some additional fee from the sale of the glasses. When any rebate method is practiced, by whatever name it is designated, which method requires the optician to split the profits with the ophthalmologist, it is probable either that an inferior quality of ophthalmic goods is supplied or that the optician's service is lacking in high standard. All rebates are a form of fee splitting which cannot be defended on any ethical ground. There can be no justification for trading on the confidence of the

> patient openly or secretly, but the secret practice is the more reprehensible. *These forms of unethical conduct are emphatically condemned by the medical profession, and those who practice them are bringing disrespect, derision and dishonor to the profession.* [Italics supplied.]

In 1942, the House of Delegates of the American Medical Association approved a resolution condemning "the unscrupulous practice of rebates to physicians * * * engaged in by various commercial organizations, laboratories, supply houses . . ." as "clearly in violation of the Principles of Medical Ethics" and directing disciplinary action against doctors engaging in such a practice. (*Infra*, pp. 76–77.) Indeed, as early as 1924 the Association's section on Ophthalmology had adopted a resolution (*quoted infra*, p. 76):

> That the acceptance of commissions or considerations, either directly or indirectly, from opticians and optical houses in the sale of glasses is absolutely contrary to all our standards of medical ethics and is just as reprehensible as the splitting of fees.

Perhaps the most comprehensive statement of authoritative medical opinion on the point is contained in an editorial formally signed by the trustees and officers of the American Medical Association and published on January 17, 1948 (136 J. A. M. A. 176–177) entitled "Rebates, Kick-

backs, Commissions and Medical Ethics."[16] Although published subsequent to the taxable years involved, the editorial shows on its face that it represents a statement of professional standards long antedating the taxable years. In this editorial the trustees and officers of the Association emphatically pointed out that (p. 78, *infra*):

> The pride of medicine as a profession has always been its freedom from the taint of barter and trade in the sick patient. Physicians must give their wholehearted devotion to the care of the patient; no other objective must be given precedence over consideration of the patient's need.

It mentions (p. 79, *infra*), that:

> Ophthalmologists have sent the patient for lenses to opticians who returned a proportion of the fee rather than to the optician who rendered the highest quality of optical service.

The editorial further states (pp. 79–80, *infra*):

> Wherever barter and trade have insinuated their insidious and evil aspects into the practice of medicine, the quality of the service has depreciated. The morals of the physicians and the commercial agencies that deal in these unwholesome profits in this marketing of medical care have already deteriorated.

[16] Authorization was formally given by the board of trustees for the publication of this editorial at its meeting in January, 1948 (136 J. A. M. A. 476). The editorial is set out in full at pp. 78–82, *infra*.

> From the beginning of its entrance on the medical scene, the American Medical Association has fought this menace to the quality of medical service and to the good repute of medical practice. Resolutions have been passed by the official bodies of the Association unequivocally condemning such practices. The Judicial Council has repeatedly urged the expulsion or other action against physicians proved to have participated in such procedures. The leaders of surgery, ophthalmology, orthopedic surgery and pharmacy have been unanimous in pointing out the extent to which such commercial considerations may break down the good repute of the specialties concerned. * * *

The Association's officers and board of trustees further point out (pp. 80–81, *infra*):

> As might have been anticipated, the ultimate development was recognition by governmental agencies of the fact that the unprotected public was being exploited by such methods. The first warning and one of tremendous significance was the indictment by the Department of Justice of two manufacturing optical agencies and of a considerable number of ophthalmologists who participated in a plan which took hundreds of thousands of dollars from unknowing patients.[10a] A full report appeared in The Journal of the American Medical Association when the Department of Justice

[10a] See *infra*, pp. 47–48.

took this action during 1946.[17] A popular periodical with millions of circulation has called on the medical profession to cleanse itself as it has repeatedly cleaned its own house in the past.[18] The House of Delegates asked the Secretary of the American Medical Association to call the situation to the attention of every state and county medical society in the nation and to urge on these societies the initiation of the necessary steps toward ridding medical practice of these parasites. The Better Business Bureaus in several large communities, notably Los Angeles, have begun a campaign of enlightenment of the public regarding the extent to which these abuses prevail in their communities; they too have called on the medical profession to take the necessary steps to stop this pernicious practice.

The editorial concludes (pp. 81–82, *infra*):

The Board of Trustees of the American Medical Association therefore calls on lead-

[17] That report, set out *infra*, pp. 75–78, was equally emphatic in condemning the rebate practice.

[18] The "popular periodical with millions of circulation", referred to in the editorial immediately above quoted, was apparently Reader's Digest which, in its January, 1948, issue published a much noticed article by Albert Q. Maisel entitled "Better Vision ... with a Kickback," 52 Reader's Digest 25. A subsequent article by the same author appeared in May, 1948, entitled "Medical Kickbacks Can Be Ended," 52 Reader's Digest 58. See also "What Do You Pay For Eyeglasses?", published in 22 Fortune 103 (October 1940), referred to by Dr. Snell, pp. 63–64 *infra*.

ers of the medical profession in every community in which the Association is represented to act promptly, remembering, however, the necessity for proceeding in due form by the filing of formal charges against physicians known to be participating in such methods, thus offering an opportunity for the presentation of evidence and a suitable hearing so that the innocent may not be harmed but the guilty may be properly exposed and punished.

The infirmity of impression made by the Association's pertinent ethic upon most of the physician witnesses at the hearing (see R. 143) may have been affected by their conceded acceptance of commissions from taxpayers, not disclosed to their patients. In addition, the physicians who were called by the Commissioner in each case were defendants in the Government's anti-trust suit (discussed *infra*, pp. 47–48) (R. 98–99, 102, 104, 111, 114, 118, 122), and had there been publicly and formally accused of engaging in a similar practice with a wholesale optician. Presumably these physicians have consented to and are now bound by the judgment in the anti-trust suit. (Appendix B, *infra*, pp. 83–92.) Under these circumstances, the witnesses were hardly disinterested or friendly to the Government's contention here.

3. *The kick-back agreements violate state and federal antitrust laws.*—As the foregoing material indicates, the illegality of the kick-back

agreements has been a matter of direct concern to the federal government under the anti-trust laws. A complaint based on Section 1 of the Sherman Act filed in 1946 in the Northern District of Illinois against two major optical companies (Respondent's Exhibit T, R. 162–180) charged that such commission or rebate arrangements between a wholesale optical company and physicians were in restraint of trade (pars. 31–41, R. 171–175) and had the effect, *inter alia*, of fixing arbitrary consumers' prices inflated by the amount of rebates given the defendant doctors (par. 42, R. 175–176). The prayer of the United States that the arrangement be declared unlawful and an injunction be granted both against the defendant optician and the participating doctors (R. 176) was granted by the consent judgment (set out in Appendix B, *infra*, p. 83) entered on May 16, 1951, in the United States District Court for the Northern District of Illinois, subsequent to the decision below. Both the defendant doctors and the optician defendants were perpetually enjoined from entering into any plan whereby the doctors received from the optician, directly or indirectly, any payment arising out of or connected with dispensing of glasses to any patient of the doctors (p. 87, *infra*).[10] Among the defendants to this

[10] Similar consent judgments were entered in the same court on the same day against other opticians and doctors in actions brought by the United States against *Bausch & Lomb Optical Company, et al.*, Civil Action No. 46C 1332;

action, who were presumably bound by the judgment, are many of the doctors to whom petitioners paid rebates (see p. 46, *supra*).

The statutes of North Carolina (2 General Statutes of North Carolina (1950), Sec. 75–1) and Virginia (Virginia Code of 1950, Annotated, Secs. 59–20 to 59–40), where taxpayers conducted business, governing intrastate commerce, contain language substantially identical with that of the Sherman Act. The arrangements disclosed were plainly unlawful under the federal act and these statutes. As the tribunals below found, the kickbacks tended artificially to increase the cost of glasses. (R. 153, 187.) Indeed, the prices charged by taxpayers to the consumers are necessarily fixed and inflated by the one-third ratio which is paid to the physician. This artificial and fixed one-third exaggeration of the cost to the consumer represents no service whatsoever by the physician to the patient. On the contrary it is part of a plan against the patient's interest. The assertion that a purchaser of glasses, whose physician is unknown, would be charged the same price as a purchaser, whose physician receives the one-third secret commission, affords no justification, but on the contrary establishes that the arrangement between the physicians and the optician results in artificial stabilization of the price in all cases and

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The House of Vision-Belgard-Spero, Inc., et al., Civil Action No. 48C 607; *Uhlemann Optical Co. of Illinois, et al.*, Civil Action No. 48C 608.

bears no relation to services rendered. As this Court has repeatedly held in construing the federal statute, price fixing agreements are unlawful *per se*. *United States* v. *Trenton Potteries*, 273 U. S. 392, 397. See also, *United States* v. *Socony-Vacuum Oil Co.*, 310 U. S. 150, 218, where this Court further said (p. 221):

> Any combination which tampers with price structures is engaged in an unlawful activity. Even though the members of the price-fixing group were in no position to control the market, to the extent that they raised, lowered, or stabilized prices they would be directly interfering with the free play of market forces. * * *

Expenses incurred in violation of statutory policies proscribing price fixing, as here, are properly denied deduction as ordinary and necessary business expenses. Cf. *Commissioner* v. *Longhorn Portland Cement Co.*; *Universal Atlas Cement Co.* v. *Commissioner*, both cited *supra*, p. 22.[20]

C. Accordingly, the claimed deductions were properly denied on grounds of public policy

The foregoing discussion makes it clear that the court of appeals' characterization of these secret

[20] The contention that these agreements violated the anti-trust laws was not urged in the Tax Court, but was presented to the court below, though not referred to in its opinion. In any event, a decision of a lower tribunal may be sustained on a new legal theory where, as here, no facts not already of record are required for decision. *Helvering* v. *Gowran*, 302 U. S. 238, 245–246, rehearing denied, 302 U. S. 781; *Hormel* v. *Helvering*, 312 U. S. 552, 558.

kick-backs as "unconscionable and reprehensible" (R. 186), is more than justified. Under well-settled principles, the agreements pursuant to which the payments were made were wholly illegal. The payments, moreover, were not merely incidentally related to the illegal schemes; they were its very heart and center. Accordingly, petitioners' bland assertions that they were not "subject to any statute or rule of law designed to deter them" from making the payments here shown, and that the payments "had not the remotest stigma of illegality" (Br. p. 26) are entirely without support.

Nor will it do to assert that petitioners are being "punished * * * by virtue of a rule of private law which is not at all aimed at them" (Petitioners' Br., p. 27). The rules designed to insure faithfulness of fiduciaries are aimed not only at the fiduciary, but at least equally at one who suborns a breach of fiduciary duty (see pp. 35–37, *supra*). To use an analogy, the giver of a bribe stands in no better light than its taker. And from the point of view of the antitrust laws, also, the companies which pay rebates are at least equally guilty with the doctors who accept them (see pp. 46–49, *supra*).

Petitioners, moreover, acted deliberately, not inadvertently. As the Tax Court said (R. 154–155):

> So far as this record reveals, all the contracts under which these "kickbacks"

were paid were made by petitioners with physicians. We think petitioners knew that fact and realized the very high degree of trust and confidence existing between those doctors and their patients. We think petitioners realized that because of that relationship the patients would follow the recommendation of the optician by the doctor, as they did, and that these considerations were what inspired the petitioners, opticians, to make these contracts and the payments, the deduction of which is in controversy.

The Tax Court's finding that the consideration for the 33⅓% commissions, which taxpayers paid to them, was the physicians' understanding or agreement to guide or recommend their patients to patronize taxpayers (see also R. 143, 146) is amply supported by the record (R. 9, 17, 22–23, 25–26, 100–101, 109, 116, 120–121). Mr. Lilly testified that in a large number of cases the patient asked his doctor for a recommendation. (R. 17.) Of course, the patient is not required to follow the doctor's recommendation, but by reason of the trust and confidence reposed in the doctor, it is likely that he will follow it (R. 143, 146, 155). That the patients typically so did is further established by the sixty odd thousand dollars kick-backs paid by petitioners to their doctors in each of the taxable years.

The Tax Court further found that in practi-

cally all instances the patient knew nothing of this arrangement; it was not disclosed to him by his physician or by taxpayers that by prearrangement one-third of the price he was charged for the glasses found its way back in his doctor's pockets. (R. 143, 153–155.) The record fully sustains this finding (R. 30, 45, 56, 64), and in any event it is apparently not in dispute. If a patient asked, he was told, but this was a very rare occurrence. (R. 143.) The physician, of course, charged a fee and in practically every instance this was all the compensation which the patient was told or understood the doctor received. (R. 143, 146.)

Accordingly, there can be no doubt that both participants in the agreements knowingly and deliberately intended a breach of the physician's fiduciary duty to his patients. Their recognition of the obvious impropriety of such arrangements is demonstrated, moreover, by the secrecy with which the arrangements were surrounded. Not only was the patient ignorant of the arrangement but, as the Tax Court found, efforts were made to conceal the agreements from others. The agreements were oral; payments under them were in many instances made in cash and those payments were camouflaged on petitioners' books under the misleading designation of "trade discounts". By no stretch of the imagination can petitioners' illegal action here be described as innocent or inadvertent. Cf. *Jerry Rossman Corp.*

v. *Commissioner*, cited *supra*, p. 22; *National Brass Works* v. *Commissioner*, cited *supra*, p. 22; *Pacific Mills* v. *Commissioner*, 17 T. C. No. 80.

In the circumstances of this case, petitioners' argument (Brief, p. 34) that the decision below involves unfair "retroactive" action, is disingenuous. Cf. *Mosser* v. *Darrow*, 341 U. S. 267, and compare dissenting opinion at p. 276. The rules against corruption of fiduciaries and pegging of prices are not innovations. They represent basic standards of honesty. The specific application of those rules to the medical profession had been authoritatively pointed out prior to the taxable years (see pp. 38–46 *supra*). The rule, denying tax deductions as "ordinary and necessary" to illegal transactions, has long been settled. The Treasury cannot be expected, by express regulation, to cover every form of commercial practice. (See R. 188.) Under these circumstances, the choice between proceeding by general rule or by ruling *ad hoc* in an individual case lies primarily in the informed discretion of the administrative agency. *Securities Comm'n* v. *Chenery Corp.*, 332 U. S. 194, 202–203. Nor does the failure of the Commissioner to deny like deductions for prior years estop him from denying them for these years. Compare *Commissioner* v. *Sunnen*, 333 U. S. 591. Indeed, in view of the elements of secrecy and camouflage already referred to, there was little to put him on notice of the true character of such payments.

Accordingly, under the principles discussed in Point I (a), *supra*, deduction of these expenses will not be allowed. In the language of this Court in the *Textile Mills* case, *supra*, 314 U. S. at 328, the payments here made are not "legitimate business expenses"; on the contrary they arise "from that family of contracts to which the law has given no sanction." The rules prohibiting enforcement of such contracts, and the policies which they violate, are at least as well settled and clearly defined as those against the lobbying activities involved in the *Textile Mills* case, or the payments for personal influence involved as in the *Rugel, Harden M. Loan Co., Easton Tractor & Equipment Co.*, and *Nicholson* cases, all cited *supra*, pp. 19–21, or the payments for referring a client to an abortionist involved in the *Giubbini* case cited *supra*, p. 21, or those in other cases in which deductions have been denied on public policy grounds.

Bateman v. *Commissioner*, 34 B. T. A. 351, 367–368, cited by the dissenting Tax Court judge (R. 160) and much relied upon by taxpayers (Br. 29, 33), approving deduction of payments in the nature of "tips" to traffic agents and railroad employees, is clearly distinguishable factually, for in contrast to the present case the Board explicitly held that (p. 367):

> There is no evidence showing that the practice was corrupt or tended to corrupt or that it was detrimental to the railroads.

Nor are petitioners aided by cases such as *Anderson* v. *Commissioner*, 81 F. 2d 457 (C. A. 10) and *Helvering* v. *Hampton*, 79 F. 2d 358 (C. A. 9) (Pet. Br., pp. 19–20) permitting deduction for civil damages paid individuals in reparation for tortious conduct. There is a sharp difference between payments which are illegal and contrary to public policy and those which constitute restitution for damages caused by prior tortious conduct. To permit the deduction of reparation payments subverts no public interest. But, as the *Textile Mills* case clearly holds, to sanction and facilitate illegal contracts by permitting tax deduction of payments made pursuant to them is plainly offensive to the public interest.

II

Even apart from considerations of public policy, petitioners have not satisfied their burden of establishing that such kick-back payments were "ordinary and necessary"

Petitioners' assumption (Br. 14) that the Tax Court and the court below "conceded that the payments to the physicians satisfied the requirements of Section 23 (a) (1) (A)" and denied the deduction only on "non-statutory" grounds of public policy, is erroneous in two respects. In the first place, as we have seen in Point I, *supra*, the construction of the statute as requiring denial of business expense deductions for payments which offend public policy is well settled. In the second place, petitioners have not, in any

event, satisfied their burden of establishing that the payments here shown were "ordinary" or "necessary" in any sense of those words. On the contrary, petitioners' contention that the secret kick-backs were normal and appropriate in the optician's trade is totally without support in any finding of the Tax Court or the court below. The Tax Court and the court below held that the kick-back practice was corrupt and neither ordinary nor necessary (R. 154–155, 158, 184, 186, 188). The facts that patients were not informed or aware of the practice, and that petitioners themselves camouflaged the payments on their books, demonstrate the extraordinary nature of those payments.

It is true that some witnesses before the Tax Court, all of whom had engaged themselves in the kick-back practice, testified that that practice was in common use in the communities in which petitioners operated. But there is nothing in the record, or in materials of which this Court can take judicial notice, to establish that it was a generally accepted practice in the optical business. On the contrary, the materials already cited from American Medical Association sources show that reputable doctors have always refused to engage in such a practice and, while referring their patients to optical companies for the manufacture and fitting of eyeglasses, have refused to accept any rebates or commissions from those companies. (See pp. 38–46, *supra*, and especially

Appendix, pp. 68, 71, *infra*.) The record discloses that petitioners' competitor in Greensboro, North Carolina, although following the practice for a while, has abandoned it. And, presumably, as a result of the antitrust actions of the Federal Government (*supra*, pp. 46–49) the principal optical companies of the United States have now abandoned it. Beyond this, it may be assumed that in North Carolina, in which state petitioners principaliy operate, no optical company now engages in the practice, since it has been expressly declared illegal by statute.

As this Court declared in *Welch* v. *Helvering*, 290 U. S. 111, 114, an expense may be deemed ordinary and necessary only if it conforms to the "norms of conduct" of the business community. "The standard set up by the statute is not a rule of law; it is rather a way of life. Life in all its fullness must supply the answer to the riddle." *Id.* at 115. The test is not whether the practice was engaged in by some opticians, or even whether it was somewhat prevalent in the optician's trade. The test is whether it conforms to the standards of the business community as a whole. Surely, this making of secret payments in corruption of a professional relationship of the utmost confidence, this greasing of palms (R. 156), is not normal in the business life of any American community; only abysmal cynicism would pretend to the contrary. Here both the

fact finder (R. 156) and the court below (R. 186) have unqualifiedly repudiated such a notion.

Thus this Court has here, in contrast to the situation in the *Heininger* case, *supra,* 320 U. S. at p. 470, the benefit of the independent judgment of the Tax Court, which denied these deductions claimed by taxpayers upon its own interpretation of the words "ordinary and necessary" as applied to its findings of fact. We submit that its informed judgment that these payments were neither "ordinary" nor "necessary" by any normal business standard should be sustained.

CONCLUSION

The decision of the Court of Appeals is correct and should be affirmed.

Respectfully submitted.

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Solicitor General.

ELLIS N. SLACK,
Acting Assistant Attorney General.

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I. HENRY KUTZ,
Special Assistants to the Attorney General.

NOVEMBER 1951.

APPENDIX A

REPRINTS FROM PROFESSIONAL MEDICAL PUBLICATIONS

I

Principles of Medical Ethics of the American Medical Association (1943):

CHAPTER I

In General

The Physician's Responsibility

SECTION 1. A profession has for its prime object the service it can render to humanity; reward or financial gain should be a subordinate consideration. The practice of medicine is a profession. In choosing this profession an individual assumes an obligation to conduct himself in accord with its ideals. (P. 3.)

* * * * * *

CHAPTER III

The Duties of Physicians to Each Other and to the Profession at Large

ARTICLE I. *Duties to the Profession*

Uphold Honor of Profession

SECTION 1. The obligation assumed on entering the profession requires the physician to comport

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himself as a gentleman and demands that he use every honorable means to uphold the dignity and honor of his vocation, to exalt its standards and to extend its sphere of usefulness. * * * (P. 6.)

* * * * * *

Deportment

SEC. 3. A physician should be "an upright man, instructed in the art of healing." Consequently, he must keep himself pure in character and conform to a high standard of morals, and must be diligent and conscientious in his studies. * * * (P. 7.)

* * * * * *

Patents and Perquisites

SEC. 5. It is unprofessional to receive remuneration from patents or copyrights on surgical instruments, appliances, medicines, foods, methods or procedures. It is equally unprofessional by ownership or control of patents or copyrights either to retard or to inhibit research or to restrict the benefit to patients or to the public to be derived therefrom. It is unprofessional to accept rebates on prescriptions or appliances, or perquisites from attendants who aid in the care of patients. (P. 8.)

* * * * * *

Safeguarding the Profession

SEC. 7. Physicians should expose without fear or favor, before the proper medical or legal tri-

bunals, corrupt or dishonest conduct of members of the profession. * * * (P. 9.)

* * * * * *

ARTICLE VI. *Compensation*

* * * * *

Commissions

SEC. 4. When a patient is referred by one physician to another for consultation or for treatment, whether the physician in charge accompanies the patient or not, it is unethical to give or to receive a commission by whatever term it may be called or under any guise or pretext whatsoever. (P. 21.)

Direct Profit to Lay Groups

SEC. 5. It is unprofessional for a physician to dispose of his professional attainments or services to any lay body, organization, group or individual, by whatever name called, or however organized, under terms or conditions which permit a direct profit from the fees, salary or compensation received to accrue to the lay body or individual employing him. Such a procedure is beneath the dignity of professional practice, is unfair competition with the profession at large, is harmful alike to the profession of medicine and the welfare of the people, and is against sound public policy. (P. 21.)

* * * * *

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Conclusion

* * * In a word, it is incumbent on the physician that under all conditions, his bearing toward patients, the public and fellow practitioners should be characterized by a gentlemanly deportment and that he constantly should behave toward others as he desires them to deal with him. Finally, these principles are primarily for the good of the public, and their enforcement should be conducted in such a manner as shall deserve and receive the endorsement of the community.

II

Principles of Medical Ethics of the American Medical Association (1949):

Chapter I

General Principles

* * * *

Patents, Commissions, Rebates and Secret Remedies

Sec. 6. * * * The acceptance of rebates on prescriptions or appliances, or of commissions from attendants who aid in the care of patients is unethical. An ethical physician does not engage in barter or trade in the appliances, devices or remedies prescribed for patients, but limits the sources of his professional income to professional services rendered the patient. He should receive his remuneration for professional services rendered only in the amount of his fee specifically announced to his patient at the time the service

is rendered or in the form of a subsequent statement, and he should not accept additional compensation secretly or openly, directly or indirectly, from any other source.

* * * * * *

III

117 The Journal of the American Medical Association 497–499 (August 16, 1941):

Some Principles of Medical Ethics Applied to the Practice of Ophthalmology[1] Chairman's address, Albert C. Snell, M. D., Rochester, N. Y.

Since my election to the chairmanship of this section, I have received considerable correspondence with reference to certain questionable practices of ophthalmologists in the dispensing of ophthalmic lenses. Also there has appeared in a high class nationally distributed magazine a critical and informative article setting forth principally those practices which are no credit to the profession. The time, therefore, seems opportune to examine some common methods of practices and to compare them with the historically established ethical principles of our profession.

The principles of medical ethics are just as binding on those practicing ophthalmology as they are on all other members of the medical profession. There are, however, some situations which are peculiar to the special practice of ophthalmology. These situations present unusual temptations to violate our best ethical

[1] Read before the Section on Ophthalmology at the Ninety-Second Annual Session of the American Medical Association, Cleveland, June 4, 1941.

standards. It is my purpose in this address to bring anew to your attention some of these principles of ethics and apply them to some common methods of practice in order that these methods may be analyzed. I hope that each individual ophthalmologist will compare his method of practice with that type of ethical conduct which is demanded by the medical profession.

It is much to be desired that both individual ophthalmologists and organized groups will strive to correct any unethical conduct that may be found to prevail. Some forms of practice not only are bringing disrespect and dishonor to the profession but much positive harm as well. When ethical principles and ideals of the medical profession are not respected by even a small group of ophthalmologists, opprobrium is placed on the entire profession, the ethical and unethical alike. Every individual ophthalmologist becomes the object of derision. This is illustrated by the article mentioned, which sets forth information of certain under-cover, questionable trade practices existing between dispensing opticians and ophthalmologists. For example, the article informs the public that the dispensing optician "may sell direct to the patient, under an arrangement which would shock that patient rudely if he understood it." The article states further that the patient may have been deluded into thinking that the wholesale price is charged by the dispenser, whereas a full retail price is collected "which he later splits, on the quiet, with your physician." This article also states that "kick-back," "furtive fee-splitting" is not exceptional; that the ophthalmologist pockets a re-

tail price for services which he does not render. This practice sometimes is given the softer and more subtle term of a "differential." All these forms of participation in the profits from the supplying of ophthalmic lenses and mountings are usually done without the knowledge of the patient and without rendering any special service to the patient. These are some of the grounds on which ophthalmologists are indicted not only by the public but also by the medical profession. What is your answer to this indictment? Shady and secret methods of rebating which are by no means uncommon can be kept in the dark no longer.

Fundamental Principles of Ethical Conduct

Let me review a few fundamental principles to which all physicians are obligated in order that a foundation may be laid for the proper answer to this indictment and that all may comprehend the approved standard of ethical conduct.

In the booklet[2] published by the American Medical Association the fundamental principle which should activate the relation between the physician and his patients is stated thus:[3]

> A profession has for its prime object the service it can render to humanity; reward or financial gain should be a subordinate consideration.

The question of proper ethical conduct can always be answered by applying this principle. Does the possibility of financial and selfish gain predominate, or do we consider the interest of the

[2] Principles of Medical Ethics of the American Medical Association, Chicago, American Medical Association, 1940.

[3] Principles of Medical Ethics, p. 3.

patient as most important? I commend the reading of this entire booklet to all ophthalmologists. It briefly and clearly sets forth the ideals which should dominate the physician's conduct and his obligations to the profession, to the public and to patients. I wish to call attention to only a few of these specific obligations which are set forth in this booklet which should be fulfilled by all ophthalmologists. The first is:[4]

> The obligation assumed on entering the profession requires the physician to comport himself as a gentleman and demands that he use every honorable means to uphold the dignity and honor of his vocation, to exalt its standards and to extend its sphere of usefulness.

The second obligation[5] is a rule of conduct relating to rebates. It is stated thus:

> It is unprofessional to accept rebates on prescriptions or appliances, or perquisites from attendants who aid in the care of patients.

The third obligation, which relates to "profits to lay groups" is stated thus:[6]

> It is unprofessional for a physician to dispose of his professional attainments or services to any lay body, organization, group or individual, by whatever name called, or however organized, under terms or conditions which permit a direct profit from the fees, salary or compensation received to accrue to the lay body or individual employing him. Such a procedure

[4] Principles of Medical Ethics, p. 6.
[5] Principles of Medical Ethics, p. 8.
[6] Principles of Medical Ethics, p. 21.

> is beneath the dignity of professional practice, is unfair competition with the profession at large, is harmful alike to the profession of medicine and the welfare of the people, and is against sound public policy.

And finally

> the duty of the physician to his patients, to other members of the profession and . . . as well as to . . . the public

is stated thus:

> It is incumbent on the physician that under all conditions, his bearing toward patients, the public and fellow practitioners should be characterized by a gentlemanly deportment and that he constantly should behave toward others as he desires them to deal with him. Finally, these principles are primarily for the good of the public, and their enforcement should be conducted in such a manner as shall deserve and receive the endorsement of the community.

Let me call your attention also to the following resolutions, which were adopted by the Section on Ophthalmology of the American Medical Association at the Chicago session in June 1924. These, however, were not presented to the House of Delegates.

> *Resolved*, That it is the sense of the Section on Ophthalmology of the American Medical Association that we deprecate the selling of glasses by the ophthalmologist to his patients, in communities where the services of reliable dispensing opticians are obtainable; and

[7] Principles of Medical Ethics, p. 24.

Resolved, That the acceptance of commissions or considerations, either directly or indirectly, from opticians and optical houses, from the sale of glasses is absolutely contrary to all our standards of medical ethics and is just as reprehensible as the splitting of fees.

These principles of ethics and the resolutions adopted by this section present the obligations which the profession regards as the minimum ethical standards of practice for ophthalmologists. From the information which I have been able to gather I fear that these standards are more "honor'd in the breach than in the observance."

The situation which is peculiar to ophthalmologists consists in the fact that the correction of errors of refraction constitutes a large percentage of his practice—from 60 to 90 per cent; and ophthalmic lenses and their mountings must be supplied and properly fitted to each individual when a correction is prescribed. This requires some form of commercial relationship with those nonmedical men who render this service. Another situation peculiar to the practice of ophthalmology is competition with optometrists in the service of correcting errors of refraction. In many communities the fee of the ophthalmologist for making the ocular examination, including that of refraction, is less than the profit made by one who furnishes the prescribed glasses. Very often too, when the prescription falls into the hands of the optometrist the patient likewise falls into his hands. The degree of cooperation between ophthalmologist and optometrist leaves very much to be desired. The advertising and

the activities of the publicity agents of the optometrists place at a disadvantage the ethical ophthalmologist who does not, will not and should not employ these methods to secure favor with a price conscious public, easily influenced by the wiles of the advertiser.

Methods of Supplying Glasses

Let us now analyze the methods, commonly employed, by which glasses are supplied and then point out briefly the ethical principles involved in the use of each method. There are at least six different methods for supplying the correcting glasses, which are as follows:

1. The first method is that in which the ophthalmologist gives the prescription for the lenses directly to the patient, who is instructed to have it filled by any reliable optician of his own choice. Should the patient request the ophthalmologist to recommend an optician, such recommendation is usually made. It is customary for the ophthalmologist to make an inspection after the prescription is filled. For the entire service of supplying a prescription and inspection the ophthalmologist receives a single fee and no other remuneration either directly or indirectly. In the use of this method he does not accept any rebate, "kick-back" or any part in the profit from the glasses provided.

2. By the second method the ophthalmologist personally furnishes the glasses. He does this either by means of an optician's laboratory, connected with his office, or by having the prescription filled and mounted by a dispensing or jobbing optician, the completed job being delivered to the

ophthalmologist who makes final inspection and adjustment, the ophthalmologist charging and collecting the prevailing retail price of the glasses in addition to his fee for examination. This is a direct and open and ethical transaction between doctor and patient.

3. By the third method the prescription is filled and the mounting completely fitted by a wholesale dispensing optician, who charges a nominal fee for the extra service of adjustment of mountings and collects the prevailing retail price for the completed work. This leaves a differential in cost between the wholesale price plus service charge and the retail price, and this differential—a profit—is credited to the ophthalmologist issuing the prescription. This method may or may not be known by the patient.

4. By the fourth method the ophthalmologist sends the patient to some chosen optician, who completes the entire work of filling the prescription, mounting, adjusting and collecting the full retail price, returning to the ophthalmologist a specified rebate, which is done without the knowledge of the patient. By some the prescription is not given to the patient but is delivered to the optician so that none may go astray.

5. The fifth method is one in which ophthalmologists have a partial or complete ownership in an optical dispensing store, which at times is designated by the more subtle name of laboratory. By this method the ophthalmologist has a direct interest in the profits from sales connected with his prescriptions. The financial interest in such stores is generally not known to the patients who

patronize such stores on advice of the ophthalmologist.

6. There is a sixth method. There are a few instances in which a physician with little knowledge of ophthalmology contracts for his services on a salary or on a percentage basis to some retail establishment where both the examination and the sales are conducted.

Comment

The first method is the ideal, ethical one; its employment is in harmony with the resolution of this section. It removes the possibility of any selfish interest or bias in the transaction of supplying glasses. This is the highest ethical form of practice and is followed by the leading ophthalmologists in the United States.

The ethics of the second method hinges on the question, under certain given circumstances of location or of availability of dependable opticians, whether adequate optician's services can be obtained. That service which has the best interest of the patient in mind is the one which should be employed; in many localities the ophthalmologist must perform the fitting and adjusting services usually rendered by the retail or dispensing optician. There is nothing unethical about this form of practice if all financial transactions are open and understood by the patient. And there can be nothing unethical in charging the established retail price for the quality of the glasses supplied, when the services of fitting, checking and adjusting are performed by the ophthalmologist. He also assumes the responsibility of the financial transactions.

The third method, the one in which the wholesale dispenser furnishes the glasses and makes some nominal charge above the wholesale price, performs the service of adjustment, inspection and collection but credits the ophthalmologist with a differential, is open to criticism, especially when no additional service is rendered for the differential, which is, of course, a rebate. And this practice is particularly reprehensible when it is done secretly.

There can, of course, be no justification whatever for the receiving of a percentage rebate for glasses which are furnished by opticians who provide all the services connected with the supplying of glasses. This practice violates every ethical medical principle of practice. Under theses circumstances the patient either receives an inferior quality of product or an inferior optical service.

The outright or partial interest in any retail optical store is an indirect method of receiving rebates, and the best ethical traditions of the profession are violated when ophthalmologists yield to this temptation to make a profit on ophthalmic supplies.

The practice of selling one's services to some lay body is a direct violation of the physician's obligation to the profession, as I have shown in the quotation from the Principles of Medical Ethics. This practice fortunately is seldom followed. No self-respecting ophthalmologist should be guilty of this unethical practice.

It is a fundamental duty of the ophthalmologist to give to his patients an unselfish, unbiased and unhampered service—the best advice which his experience and knowledge dictate. It is very

questionable whether such service can be rendered without some degree of prejudice, perhaps unconsciously, by an ophthalmologist who has a financial interest in the commercial side of supplying the equipment. As far as refractive problems are concerned, patients consult the ophthalmologist not primarily to get a pair of lenses but to find out whether or not there is need for them. The answer to that problem should be answered without any bias.

It seems to me that the crux of unethical practices lies primarily in some secret form of rebate, differential or kick-back—to some furtive participation in the profits connected with the supplying of lenses and their mountings, which participation is done without the knowledge of the patient. As a consequence of this method of practice, patients are compelled to pay for services which are not rendered either by the ophthalmologist or by the optician. Evidently this practice does not consider the best interest of the patient.

When an adequate and proper fee is made for the professional services rendered, the ophthalmologist is not ethically entitled to some additional fee from the sale of the glasses. When any rebate method is practiced, by whatever name it is designated, which method requires the optician to split the profits with the ophthalmologist, it is probable either than an inferior quality of ophthalmic goods is supplied or that the optician's service is lacking in high standard. All rebates are a form of fee splitting which cannot be defended on any ethical ground. There can be no justification for trading on the confidence of the patient openly or secretly, but the secret

practice is the more reprehensible. These forms of unethical conduct are emphatically condemned by the medical profession, and those who practice them are bringing disrespect, derision and dishonor to the profession.

In an address delivered at a recent meeting of the Medical Society of the County of Monroe in New York State, Dr. Van Etten, President of the American Medical Association, said that organized medicine had always upheld the highest ethical standards and "The parent organization has never sold us down the river because of any form of commercial or legislative pressure." Surely the Section on Ophthalmology of the parent organization will not be the exception to this ethical history. No ophthalmologist should be guilty of participation in the secret distribution of profits in the supplying of glasses, nor should he be guilty of trading on the confidence of his patients. Every ophthalmologist should conduct his practice and his relationship with lay bodies so that he will serve the best interests of the public, the patients and the profession. Only in this way will he help to remove the indictment against ophthalmologists and help to maintain the good repute of our honored profession at its historic ethical standard.

53 South Fitzhugh Street.

IV

EDITORIALS

131 The Journal of the American Medical Association 1128 (August 3, 1946):

Indictment of Optical Firms and Ophthalmologists Under Sherman Act

Elsewhere in this issue (page 1138) appears a condensation of two complaints filed by the United States through the Department of Justice charging optical wholesalers and ophthalmologists with violating the Sherman Act by fixing prices on spectacles through rebating to the ophthalmologists approximately one half of the total price paid by their patients for eyeglasses. The Department of Justice adopted the unusual device by selecting certain physicians as representative of the entire class of physicians securing rebates as defendants in the suit. Attorney General Tom C. Clark said in connection with the filing of the suits that "the department is informed that the rebating practice is industry wide and it is presently expediting its investigation of all wholesale dispensers in the optical field. If investigation discloses similar practices, additional suits will be filed as quickly as possible." The newspaper release made by the Department of Justice states that some individual physicians receive as much as $40,000 annually in rebates. The actual figures cited in the complaint indicate instances in which a Chicago patient was charged $14 for lenses, the optician receiving $2.50 and the physician $11.50; an instance in which a patient paid $25 for lenses, the company

receiving $10.80 and the physician $14.20. A Dallas patient paid $21 for lenses, which was divided approximately equally between the optician and the physician, and an Oklahoma City patient paid $22, the manufacturer receiving $9.10 and the physician $12.90. Similar figures are available for prescriptions filed in Madison, Wis., Minneapolis and Denver. Moreover, the actual cumulative figures indicate that one group of physicians in Iowa received more than $42,000. One physician in a small town in Texas received almost $15,000, a sum equaled by physicians in Minneapolis, Waterloo, Iowa, Rockford, Ill., and other small communities.

The position of the American Medical Association on this practice has been stated definitely on several occasions. In 1924 the Section on Ophthalmology of the American Medical Association adopted a resolution stating:

> *Resolved,* That the acceptance of commissions or considerations, either directly or indirectly, from opticians and optical houses in the sale of glasses is absolutely contrary to all our standards of medical ethics and is just as reprehensible as the splitting of fees.

That resolution was not presented to the House of Delegates and was therefore an action of the section but not an action of the American Medical Association. In 1942 a resolution was presented to the House of Delegates to the effect that

> it be declared unethical for the members of the American Medical Association or its component branches to refer patients to commercial organizations, laboratories or other physicians who advertise to the pub-

lic and others than the medical profession who employ steerers or cappers or who offer to pay rebates or commissions or in any other manner violate the principles of Medical Ethics of the American Medical Association or its component branches.

This resolution was referred to a reference committee, which brought back a revised resolution to the House of Delegates. The following revised resolution was adopted:

Resolutions on Rebates: Your reference committee has given very serious consideration to these resolutions. It is the opinion of your reference committee that the practices referred to in the resolutions are beneath the dignity of a learned profession, are basically dishonest and are a violation of the Principles of Medical Ethics. Your reference committee therefore recommends that the following substitute resolutions be adopted:

Whereas, It has been brought to the attention of the House of Delegates that the unscrupulous practice of rebates to physicians is being engaged in by various commercial organizations, laboratories, supply houses and in some professional relationships between certain physicians; and

Whereas, All such practices are clearly in violation of the Principles of Medical Ethics; therefore be it

Resolved, That the House of Delegates of the American Medical Association express stern disapproval of the practice by any of the members of its component societies of referring patients to commercial organizations, laboratories or other physicians who advertise to the public and

others than the medical profession, who employ so-called steerers or cappers or who pay, or offer to pay, rebates or commissions in any guise whatsoever, or who in any other manner violate the Principles of Medical Ethics of the American Medical Association; and be it further

Resolved, That any member violating these resolutions be subject to such disciplinary action as is deemed advisable by the county society in which such physician holds membership; and be it further

Resolved, That the Secretary of the American Medical Association be instructed to send a copy of these resolutions to each state and county society accompanied by a letter to the secretary of each setting forth that all such unethical practices are disreputable and unscrupulous and, if not controlled, may soon besmirch the reputation of the entire medical profession.

V

136 Journal of the American Medical Association 176–177 (January 17, 1948):

Rebates, Kickbacks, Commissions and Medical Ethics

The pride of medicine as a profession has always been its freedom from the taint of barter and trade in the sick patient. Physicians must give their wholehearted devotion to the care of the patient; no other objective must be given precedence over considerations of the patient's need. Nevertheless, the charge is made that some physicians have forgotten the ethical principles that prevail in the relationship between doctor

and patient and have selected the surgeon willing to make the greatest division of fees rather than the one best suited to perform the operation. Ophthalmologists have sent the patient for lenses to opticians who returned a proportion of the fee rather than to the optician who rendered the highest quality of optical service. Occasionally orthopedic surgeons and others who utilize the work of the maker of braces, splints and elastic bandages have been willing to accept commissions from such manufacturers and have designated the procurement of these accessories to the agency offering the largest commission rather than to the one most painstaking in production and most reasonable in price. From time to time criticism has been leveled against pharmacists who have offered commissions to physicians on the prescriptions sent to them and to the physicians who have accepted such commissions. Wherever barter and trade have insinuated their insidious and evil aspects into the practice of medicine, the quality of the service has depreciated. The morals of the physicians and the commercial agencies that deal in these unwholesome profits in this marketing of medical care have already deteriorated.

From the beginning of its entrance on the medical scene, the American Medical Association has fought this menace to the quality of medical service and to the good repute of medical practice. Resolutions have been passed by the official bodies of the Association unequivocally condemning such practices. The Judicial Council has repeatedly urged the expulsion or other action against physicians proved to have participated in such procedures. The leaders of surgery, ophthal-

mology, orthopedic surgery and pharmacy have been unanimous in pointing out the extent to which such commercial considerations may break down the good repute of the specialties concerned. The American College of Surgeons adopted an oath to be taken by its fellows to the effect that they would not participate in the secret division of fees. The Principles of Ethics of the American Medical Association have declared the unethical character of such divisions—direct or indirect.

Now the development of greater complexity in medical practice and in medical relationships has introduced new factors into this problem of barter and trade. The development of roentgenology as an important medical specialty and the establishment of clinical pathologic laboratories to which physicians send patients for the making of highly technical and often costly tests have introduced new sources of rebates, kickbacks and commissions. In some communities means have been proposed for evading the condemnation of medical organizations and societies through the establishment of corporations, cooperative laboratories and roentgenologic offices of multiple ownership.

As might have been anticipated, the ultimate development was recognition by governmental agencies of the fact that the unprotected public was being exploited by such methods. The first warning and one of tremendous significance was the indictment by the Department of Justice of two manufacturing optical agencies and of a considerable number of ophthalmologists who participated in a plan which took hundreds of thousands of dollars from unknowing patients. A full

report appeared in The Journal of the American Medical Association when the Department of Justice took this action during 1946. A popular periodical with millions of circulation has called on the medical profession to cleanse itself as it has repeatedly cleaned its own house in the past. The House of Delegates asked the Secretary of the American Medical Association to call the situation to the attention of every state and county medical society in the nation and to urge on these societies the initiation of the necessary steps toward ridding medical practice of these parasites. The Better Business Bureaus in several large communities, notably Los Angeles, have begun a campaign of enlightenment of the public regarding the extent to which these abuses prevail in their communities; they too have called on the medical profession to take the necessary steps to stop this pernicious practice.

The housecleaning has been too long delayed. Biology has proved that any living organism that tries to maintain itself in the presence of filth invariably dies. The Board of Trustees of the American Medical Association therefore calls on leaders of the medical profession in every community in which the Association is represented to act promptly, remembering, however, the necessity for proceeding in due form by the filing of formal charges against physicians known to be participating in such methods, thus offering an opportunity for the presentation of evidence and a suitable hearing so that the innocent may not be harmed but the guilty may be properly exposed and punished.

APPENDIX B

In the District Court of the United States for the Northern District of Illinois, Eastern Division

Civil Action No. 46 C 1333

UNITED STATES OF AMERICA, PLAINTIFF

v.

AMERICAN OPTICAL COMPANY, ET AL., DEFENDANTS

FINAL JUDGMENT

Plaintiff, United States of America, filed its complaint herein on July 23, 1946, and filed an amendment thereto on October 28, 1946. Thereafter, the corporate defendants and the defendant individual doctors appeared and filed their answers and amended answers to the amended complaint, denying the substantive allegations thereof and any violations of law.

Subsequent to the filing of the compaint, the corporate defendants, without prior notice to the plaintiff or the Court, discontinued dispensing at all of their branches where such business was carried on and, in connection with such discontinuance in certain locations, transferred the dispensing businesses and/or assets relating thereto in such locations to defendant transferees, who have been and are on the date of entry of this judgment engaged in dispensing on their own behalf.

On September 18, 1950, leave of Court having first been obtained, plaintiff filed a supplemental

complaint relating to such transfers to the defendant transferees.

On February 26, 1948, the Court entered an order directing the defendant class doctors whose names were set forth in an exhibit attached to said order, to appear and show cause why such doctors should not be bound by any judgment entered in this case. (A copy of such order, omitting the list of names, is attached hereto as Exhibit 1.) Exhibit 2, also attached hereto, sets forth the names of each defendant class doctor who either received mailing and service of the aforesaid orders and failed to show cause why he should not be bound by any judgment entered in this case, or who submitted himself to the jurisdiction of this Court and agreed to be bound by such judgment, whether after trial or by consent of the parties.

Each of the corporate defendants, defendant individual doctors, and defendant transferees hereby consents to the entry of this final judgment. The consent of each defendant individual doctor is made both as an individual and as a representative of the defendant class doctors as hereinafter defined.

Now, therefore, upon such consents, no testimony having been taken, and without any finding or adjudication of fact or as to past specific transactions, or any admission by reason of such consents or this judgment, excepting only the statements hereinabove set forth, which are made solely for the purpose of this proceeding; it is hereby

Ordered, adjudged and decreed as follows:

I. This Court has jurisdiction of the subject

matter and of all defendants named in the complaint, as amended, including the defendant class doctors named in Exhibit 2 and the defendant transferees named in the supplemental complaint herein; any agreement, understanding and concert of action, whether written or oral, express or implied, of the type charged in the complaint, involving payment by any corporate defendant, directly or indirectly, to any of the defendant individual doctors or to defendant class doctors, or to any agent, representative, employee or designee of any such doctor, of the whole or any part of the purchase price of ophthalmic goods collected by any such corporate defendant whether or not as agent or purported agent of such doctor) from any one or more patients of any such doctor, and whether in the form of, or described or regarded as a rebate, credit, credit balance, gift, dividend, or participation or share in profits, or otherwise, is hereby adjudged to be in violation of Section 1 of the Sherman Act; and the complaint, as amended, and the supplemental complaint state a cause of action under Section 1 of the Sherman Act (15 U. S. C. Sec. 1), upon which relief may be granted.

II. Wherever used in this judgment:

(a) "Corporate defendants" means American Optical Company, an association, American Optical Company, a corporation, and their respective successors, assigns, officers, directors, agents, employees and representatives, and each and every other person acting or claiming to act under, through, or for such defendant, excluding, however, the defendant individual doctors, the defendant class doctors and the de-

fendant transferees, as hereinafter respectively defined.

(b) "Defendant individual doctors" means those oculists named in the complaint as individual defendants and as representatives of the defendant class doctors and each person acting or claiming to act under, through, or for any such defendant individual doctor.

(c) "Defendant class doctors" means those oculists whose names are listed in Exhibit 2 attached hereto, and each person acting, or claiming to act, under, through, or for any such doctor.

(d) "Defendant transferees" means those persons who are named as defendants in the supplemental complaint herein and each person acting or claiming to act under, through, or for any such transferee.

(e) "Person" means an individual, proprietorship, partnership, association, joint stock company, business trust, corporation, or any other business organization or enterprise.

(f) "Ophthalmic goods" means ophthalmic lenses, lens blanks, spectacle frames, mountings, eyeglasses, spectacles, and component parts or combinations of any of these articles sold or offered for sale within the United States, its territories and possessions, and as so defined does not include sunglasses or industrial safety equipment not containing lenses ground to prescription.

(g) "Dispensing" means the sale within the United States, its territories and possessions to consumers, of ophthalmic goods, particularly of spectacles and parts thereof, and of repair parts and services in connection therewith, and/or the measurement of facial characteristics for spectacles and

the fitting and ajustment of such spectacles to the face.

(h) "Dispenser" means one who engages in dispensing. The term shall not be deemed to apply to a refractionist who engages in dispensing in his own professional offices (either himself or through a bona fide employee) to his own patients only.

(i) "Consumer" means any person who wears spectacles, or any patient for whom spectacles have been prescribed by a refractionist.

III. Each defendant individual doctor and defendant class doctor is hereby perpetually enjoined:

(a) From accepting, directly or indirectly, or designating any other person to thus accept, from any dispenser (whether such dispenser acts or purports to act as an agent of the doctor, or otherwise), any payment arising out of or connected with dispensing to any patient of such defendant doctor, whether such payment is in the form of, or is described or regarded as a rebate, credit, credit balance, gift, dividend, participation in or share in profits, or otherwise;

(b) Entering into or participating in any plan, arrangement, or scheme whereby said defendant doctor receives from any dispenser (whether such dispenser acts or purports to act as agent of the doctor, or otherwise) directly or indirectly in any form (including any of the forms and methods referred to above) any payment arising out of or connected with dispensing to any patient of such defendant doctor.

IV. Each of the corporate defendants and each of the defendant transferees is hereby perpetually enjoined from making, directly or indirectly, any payment to any refractionist (including any oculist), or any agent, representative, employee or designee of any refractionist, arising out of or connected with dispensing, whether or not such payment is in the form of, or is described or regarded as, a rebate, credit, credit balance, gift, dividend, participation in or share in profits, or otherwise; and whether such payment constitutes an individual transaction, or is part of any plan or program.

V. Each of the corporate defendants is hereby perpetually enjoined from:

(a) Enforcing, performing, or entering into any agreement, contract, or understanding with any defendant transferee by which such defendant transferee agrees to purchase from any corporate defendant the defendant transferee's requirements or substantial requirements of any ophthalmic goods, supplies, or equipment for any designated period of time, or any specified volume of such goods, supplies, or equipment beyond those needed by the defendant transferee for his current business requirements and requested by him in the exercise of his own free choice; or agrees in advance to place orders for any shop work to be done by a corporate defendant.

(b) Enforcing, performing, or entering into any contracts, agreements, or understandings covering, or issuing any schedules fixing, or systematically suggesting, the consumer prices, terms, or conditions

of sale on which any defendant transferee shall sell ophthalmic goods.

(c) Enforcing, performing, or entering into any contract, agreement, or understanding with any defendant transferee dictating, prescribing, or suggesting to any such defendant transferee any arrangement restraining or limiting such defendant transferee as to the territory in which he shall operate or do business, or restraining or limiting the type of business such defendant transferee may engage in or enter into.

(d) Dominating, controlling, or interfering with, or attempting to dominate, control or interfere with, the prchasing, financial, promotional, or other business policies, practices, operation, management, expansion or other activities of any such defendant transferee.

(e) Enforcing, performing, or entering into any agreement, contract, or understanding under which any corporate defendant grants any credit, discount, rebate, or allowance, based on a percentage or other proportion of the amount of ophthalmic merchandise purchased from such defendant, which credit, discount, rebate, or allowance is applied, or to be applied, in whole or in part, to reduce indebtedness incurred by any defendant transferee in connection with the acquisition from any corporate defendant of dispensing assets, or the dispensing business, of one or more of the branches of any corporate defendant.

VI. Each of the corporate defendants is hereby enjoined for a period of ten years from the date of entry of this judgment from engaging in the business of dispensing, and from acquiring or

holding any ownership interest, whether through the purchase or ownership of assets, stock or otherwise, in any person who engages in such business of dispensing.

VII. The corporate defendants, each of the defendant individual and class doctors, and each of the defendant transferees, are hereby perpetually enjoined from entering into any agreement, understanding or concert of action with any other person or persons, fixing or attempting to fix the consumer price to be charged for ophthalmic goods or services, and from dictating, prescribing, controlling or interfering with, or attempting to dictate, prescribe, control, or interfere with the consumer prices charged or to be charged by any other person or persons for such ophthalmic goods or services; provided, however, that nothing contained in this judgment shall be deemed to prevent or restrain any of the defendants after the expiration of the injunction contained in Section VI hereof from making such suggestions or making and enforcing such agreements as to prices as may then be lawful.

VIII. The plaintiff shall mail a copy of this judgment to each member of the defendant class doctors whose name is set forth in Exhibit 2, attached hereto and made a part hereof. Such mailing shall be by franked envelope to the last known address of each of such defendant class doctors, and the plaintiff, after making such mailing, shall file an affidavit of mailing with the Clerk of this Court. The plaintiff may transmit with such mailing a letter, in a form to be approved by the Court, covering the transmission

of such judgment and explaining the application of the judgment to the doctor.

IX. For the purpose of securing compliance with this judgment, and for no other purpose, duly authorized representatives of the Department of Justice shall upon written request of the Attorney General or an Assistant Attorney General and on reasonable notice to any defendant made to its principal office be permitted, subject to any legally recognized privilege, (1) access during the office hours of said defendant, to all books, ledgers, accounts, correspondence, memoranda and other records and documents in the possession or under the control of said defendant relating to any matters contained in this judgment and (2) subject to the reasonable convenience of said defendant and without restraint or interference from it to interview such defendant, or officers or employees thereof, who may have counsel present, regarding any such matters; provided, however, that no information obtained by the means provided in this paragraph shall be divulged by any representative of the Department of Justice to any person other than a duly authorized representative of such Department except in the course of legal proceedings to which the United States is a party for the purpose of securing compliance with this judgment or as otherwise required by law.

X. Jurisdiction of this Court is retained for the purpose of enabling any of the parties to this decree to apply to the Court at any time for such further orders and directions as may be necessary or appropriate for the construction or carrying out of this judgment, for the modification

thereof, or the enforcement of compliance therewith and for the punishment of violations thereof.

Dated: , 1950.

WALTER J. LA BUY,
United States District Judge.

May 16, 1951.

We hereby consent to the entry of the foregoing judgment.

For the plaintiff:

H. G. MORISON,
Assistant Attorney General.

SIGMUND TIMBERG,
Special Assistant to the Attorney General.

WILLIS L. HOTCHKISS,
Special Assistant to the Attorney General.

HARRY R. TALAN,
Special Attorney.

For the Defendants:

AMERICAN OPTICAL COMPANY,
an association.

AMERICAN OPTICAL COMPANY,
a corporation.

By GEORGE A. RANNEY, JR.,
Attorney.

U. S. GOVERNMENT PRINTING OFFICE: 1951